

How has the United States Leveraged Economic Crises into its Hegemony?

A case study of the Bretton Woods Regime's Collapse and Replacement, 1969-76

Volume I (of II)

Submitted by Martin Charles Williamson, to the University of Exeter as a thesis for the degree of Doctor of Philosophy in Politics in April 2018.

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Abstract

International monetary and financial crises have punctuated US hegemony since 1945. With US hegemony likely to endure and crises likely to recur, we need to understand how the US reacts to such events: benevolently or exploitatively? Using a case study of US behaviour during the 1969-76 international monetary crisis, this thesis aims to challenge narratives that interpret events in terms of the concentration or deconcentration of power in the US hegemon in favour of an explanation of US behaviours based on the interplay of US domestic politics and international security imperatives.

Using a Constructivist definition of hegemony and a neoclassical realist theoretical framework, I analyse the crisis from the perspectives of the international monetary order and system, respectively. I introduce a novel division of Strange's concept of structural power into its negative and positive components (the power to block or create international structures, respectively). Using these analytical tools, I analyse documents held in the UK and US National archives, President Nixon's White House tapes and the Bank of England archive.

Key and original findings include:

- US tactics veered between hegemony by consent and, when that failed to yield the results, hegemony through domination;
- domination tactics could be brutal, as when President Nixon and his National Security Advisor, Kissinger, tried to wreck European integration by destroying its first attempt at monetary union. Their intention was to advance the US' security agenda by weakening EEC states;
- Kissinger intervened in the Committee of Twenty's negotiations to delay agreement on international monetary reform (despite the US being on the verge of achieving its objectives) until European states had acceded to what he wanted on security in the "Year of Europe" negotiations. Delay killed US plans to return to fixed exchange rates;

- hegemonic stability theory-based explanations of events are challenged by the US terminating its Bretton Woods regime, persuading follower states to introduce generalised floating and blocking international monetary reform;
- structural Realist and Marxist narratives of the crisis are challenged, *inter alia*, by President Ford abandoning Nixon's attempts to strengthen US hegemony in favour of a *laissez-faire* solution to the international monetary crisis;
- the decisions creating the basis of a neoliberal international monetary order – the introduction of floating exchange rates and free capital mobility – were taken for US international security or domestic political reasons, as neoclassical realism would predict. These decisions had profound economic consequences, but were not taken for economic reasons.

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Chapter 1

Introduction: Background and Key Concepts

“Memory is always about the present.”

Professor David Blight¹

This chapter sets out my aims and objectives, my research methodology, the main results and their contemporary relevance. It also discusses three concepts central to my analysis: order and system; power (including my novel distinction between negative and positive structural power); and Mundell’s trilemma. The chapter concludes by outlining how my material is organised in the following eight chapters.²

Aims, Objectives, Research Methodology, and Main Results

US hegemony has been a continuing feature of the international order since 1945 and will persist for many years. US hegemony has been punctuated by international monetary and financial crises and doubtless there will be more crises in future. Other states therefore need to understand how their US hegemon behaves during international monetary crises. Will the US act as a benevolent hegemon in these circumstances, putting its responsibility for maintaining international order above narrow national interests? Or will Washington regard an international monetary crisis as an opportunity to strengthen US hegemony, possibly at follower states’ expense? I aim to shed new light on US behaviours using a case study of the protracted international monetary crisis of 1969-76. My objective is to develop an understanding of US behaviour and purposes during the crisis’ five key episodes in order to draw policy-relevant conclusions about US hegemony.³

¹ Quoted in *The Economist*, 25 July 2015

² My literature review is included in chapter 2; this is supplemented with reviews of the literature on specific episodes of the 1969-76 international monetary crisis in chapters 6 and 7.

³ The key episodes were Nixon closing the Bretton Woods regime’s gold window in August 1971; the Smithsonian Agreement of December 1971; the introduction of generalised

The literature on US hegemony during 1969-76 focuses on the reasons for the demise of the Bretton Woods regime based on fixed exchange rates and widespread capital controls, and its replacement with a neoliberal regime of floating exchange rates and free capital mobility. Was this due to a deconcentration of power in the international system that left the US too weak to maintain the international monetary order it had put in place in 1944? Or was it due to power being concentrated in the US, enabling Washington to use “structural power” to replace the Bretton Woods regime with another more to its liking? Hegemonic stability theory advocates, mainly Liberals, prefer the former explanation; structural Realists and many Marxists prefer the latter.

My archive-informed findings are inconsistent with both hegemonic stability and structural power-based explanations of US behaviours and purposes, but do fit with neoclassical realism’s perspective: agency as well as structure mattered when the US tackled the international monetary crisis, and domestic political factors were sometimes important determinants of US foreign economic policy. For that reason I have adopted neoclassical realism as the theoretical framework for my thesis.

My research into the US’ hegemonic behaviours and purposes draws heavily on archived documents. In particular I rely on documents from the US and UK National Archives, the Bank of England’s archive and President Nixon’s White House tapes. These documents often confirm, but sometimes contradict the evidence one finds in key policymakers’ published diaries and memoirs. The contradictions can be startling, revealing US actions and intentions that scholars have not previously perceived. Highlighting these unreported events is one of this thesis’ original contributions to the IPE literature. The documents were, of course, released after many scholars had published their interpretations of the international monetary events of 1969-76.

The archived materials offer original perspectives on events, enabling us to perceive them through the eyes of policymakers and senior officials tasked with crisis management. Drawing on these sources, and using my novel distinction between “positive” and “negative structural power”, enables me to

floating exchange rates for G10 states in March 1973; the Committee of Twenty’s discussion of international monetary reform, September 1972-June 1974; and the Rambouillet Economic Summit in November 1975.

reinterpret US behaviours and intentions during 1969-76. I find the US *under Nixon* attempted to exploit the international monetary crisis to strengthen its hegemony. When Nixon's hegemony by consent tactics failed, he veered into adopting hegemony by domination tactics, as when he closed the gold window in 1971 and lured G10 states into generalised floating in March 1973, as well as when Kissinger insisted the US halt progress on international monetary reform in September 1973, despite being on the verge of achieving the US' main objectives: a new monetary order based on fixed exchange rates and the SDR replacing the dollar as the order's main reserve asset.

The US *under President Ford* did not seek to use the international monetary crisis to strengthen US hegemony. Ford was not interested in engaging in protracted international negotiations: he wanted to clear the decks of distractions and focus on his presidential election campaign. In an abdication of US monetary hegemony, Ford obtained the *laissez-faire* exchange rate rules agreement, the minimum he needed at the Rambouillet Economic Summit. His success had not been a foregone conclusion: archived materials show many in Washington expected Ford to fall into a Franco-German trap, but France chose not to spring its trap, probably because Ford had made important pre-Summit gold rules concessions to France (the US' main monetary adversary during 1969-76). This agreement enabled the US to float the dollar without international sanctions, but did not impose floating exchange rates on others. Thus the archived materials, by revealing the weakness of US structural power in the immediate post-Watergate period, challenge the structural Realists' and Marxists' narrative of an all-powerful US imposing a new international monetary structure on the world in 1976.

The archived materials reveal sometimes astonishing evidence of US behaviours when pursuing hegemony by domination under Nixon. The materials confirm what we already knew about US behaviours and intentions when Nixon closed the gold window in 1971. US motives for introducing generalised floating exchange rates in 1973, however, are less well-known. The generally-accepted explanation in the scholarly literature is that the US persuaded G10 states to introduce floating exchange rates for economic reasons. The archives reveal something very different: generalised floating came about because the US was pursuing political and security foreign policy

objectives, not an economic objective, still less a new economic structure. Hegemonic stability theory advocates argue the US did so because it was too weak to sustain a fixed exchange rate regime; structural Realists and some Marxists argue the US did so as part of its efforts to create a new, neoliberal international monetary order. The archives show both explanations are wide of the mark. They show Nixon and Kissinger, notwithstanding their professed support for the EEC in public, concluded in private the US' traditional policy of building a strong EEC was no longer appropriate as the world moved from bipolarity towards multipolarity. Europe, a US ally under bipolarity would become a rival under multipolarity. They therefore decided to damage European integration by wrecking the EEC's first attempt at monetary union. They believed luring the EEC into an unsustainable common currency float against the dollar would do the trick, while leaving the US apparently blameless. The upshot, they hoped, would be a weakened and divided Europe unable to resist US demands in various security negotiations.

Archived documents pertaining to international monetary reform reveal Kissinger insisted foreign policy objectives should override Treasury Secretary Shultz's foreign economic policy objectives as the Committee of Twenty neared agreement on international monetary reform in 1973. Kissinger wanted to hold international monetary reform hostage to progress on the US' security agenda in the "Year of Europe" negotiation. Shultz acquiesced, believing the delay would be temporary, but OPEC's decision to quadruple oil prices shortly afterwards changed the world economy's structures, rendering the US reform plan redundant. It was never implemented.

The archived documents also reveal how France had almost eclipsed US monetary hegemony by 1975. Britain, the FRG, Italy and Japan stated they were as willing to endorse France's vision for a reformed international monetary order as they were to endorse the US' version. Watergate's damage to US legitimacy and OPEC seizing control of world oil markets left the US unable to use positive structural power effectively in the monetary area. Ford did not even try. Instead, Washington skirted around the problem by initiating low-level technical co-operation with other states to build new, specialised financial regimes. These eventually helped prepare the world for free capital mobility.

Case Study Relevance: Nixon/Trump Parallels

Archived materials must be interpreted in the context of their time. The international monetary crisis of 1969-76 gave birth to financialisation of the world economy, whereas the Credit Crunch that started in 2007-8 and rumbles on to this day occurred at a mature phase of financialisation.⁴ Circumstances differed considerably. Yet the past is not always another country: there are many parallels between the Nixon and Trump administrations.

Nixon and Trump took office facing challenges from rising powers, the USSR and China respectively. Gilpin predicted a challenged hegemon would at some point face a “fiscal crisis”, a description equally applicable to Nixon’s and Trump’s situation.⁵ Both men came to power when their country’s resources were stretched to breaking point: Johnson had attempted to fund the Vietnam War and his Great Society domestic social programmes; Trump inherited President Obama’s expensive new healthcare entitlements and deficits on the US’ fiscal and current accounts. Consequently deficit management became an issue for Nixon and Trump. Both had to confront order-threatening international financial crises. And both responded with calls for US retrenchment - the “Nixon Doctrine” and “America First”, respectively - while simultaneously asserting their determination to sustain US international leadership.

Nixon and Trump took office when it appeared the world was moving towards multipolarity, with US hegemony weakening and rivals’ military and economic power growing. Both wanted to maximise US leverage over other states by dealing with them bilaterally rather than multilaterally. Both wished to degrade European integration: Trump overtly, Nixon covertly. Both promised to end US involvement in wars (Vietnam and Afghanistan, respectively), but both found it hard to withdraw boots from the ground. Both believed the international economic rules were biased against the US, enabling the US’ trade partners to benefit from protectionism and unfairly-maintained competitive exchange rates. And both believed the US’ allies should pay more for their defence.

⁴ In the form of protracted quantitative easing, distorted capital and asset markets and incomplete restructuring and implementation of financial regulation.

⁵ Gilpin, *War and change*, 185: “Once a society reaches the limits of its expansion, it has great difficulty in maintaining its (international) position and arresting its eventual decline... it begins to experience a severe fiscal crisis.”

These parallels, which emerge against a background of almost unchanged US domestic political structures, suggest 1969-76's strategic and tactical considerations remain relevant: both presidents sought a way out of the international financial crisis of their day that would enhance US hegemony.

Three Analytical Concepts

Three concepts, two from international relations scholarship and one from economics, feature heavily in this case study: the distinction between order and system; power, notably structural power; and, "Mundell's trilemma".

1. Order and System

McKinnon defined an order as "the framework and setting in which a system operates. It is a framework of laws, conventions, regulations and mores that establish the setting of a system and the understanding of the environment of the participants in it." ⁶ He defines a system as "an aggregation of diverse entities united by regular interaction according to some form of control." In the context of this case study, the system is constituted by the behaviour of states and other economic entities (especially banks) which interact in the financial sphere (i.e. monetary and credit interactions) through foreign exchange, capital and commodity markets (notably the market for gold); control is exerted by national and international regulations, the latter under the auspices of the International Monetary Fund (IMF) and the Bank for International Settlements (BIS), and by inter-state co-operation agreements.

An international monetary order is easily understood as the internationally-accepted rules for international monetary relations, both formal and informal. The order may change over time, but change will be discontinuous and will require states to use formal decision-making and rule-creating mechanisms. The IMF, being central to the international monetary

⁶ Definitions used by McKinnon and Cohen are almost identical. See McKinnon, *The rules*, 1, and Cohen, *Organizing the world's money*, 3-4.

order, captures many of its formal rules in the IMF's *Articles of Agreement*. The *Articles* are at once the IMF's founding document, its charter, and the international monetary order's "constitution". It is conceivable, for instance, to amend the *Articles* in ways that merely affect how the IMF operates internally and does not significantly affect the international monetary order.⁷ It is almost inconceivable, however, to imagine changes to the international monetary order not being reflected in amendments to the *Articles*, unless the changes included abolishing the IMF or its central role.⁸ Thus any state wishing to change the international monetary order must also change the IMF's *Articles of Agreement*.

The international monetary system, in contrast, represents the *behaviour* of the states and private sector entities engaged in international monetary affairs. It is organic in the sense that behaviours may change gradually (or abruptly) over time without reference to the order's rules. If such changes progress to the point where behaviours strain the order's rules, crises may ensue. An order may contain a degree of elasticity in its rules (or in participants' interpretations of them). But no order can be infinitely elastic. It must impose a measure of control over the behaviours of the system's participants, without which it would be pointless.

2. Power

The concept of power is central to international relations scholarship, yet the discipline finds the concept rather slippery. Barnett and Duvall created a taxonomy of power in their attempt to clarify understandings. They define power as "the production, in and through social relations, of effects on actors that shape their capacity to control their fate."⁹ They describe power in terms of two analytical dimensions. Their first refers to social relations, ranging from "social relations of interaction" between actors to the "social relations of constitution". The actors may be states or other political or economic bodies.

⁷ One could, say, introduce a rule that all IMF employees must be citizens of member states. This would affect IMF employment practices, but not the international monetary order.

⁸ The exception concerns rules for central banks, where the Bank for International Settlements is a key rule-making institution. It may affect the international monetary order through, for example, rules for central banks' handling of monetary gold.

⁹ Barnett and Duvall, *Power in international politics*, 42

Power in “social relations of interaction” is an attribute of an actor, which can be differentiated according to, say, the military, economic or other material and intellectual resources they possess. Power in “social relations of constitution” is the power social orders, systems and structures exert over specific actors to define their individual characteristics and capacities. The “social relations of constitution” shape an actor’s capacities and interests.

Barnett and Duvall’s second dimension specifies the degree to which social relations operate on states directly or through socially diffuse mechanisms. A bilateral negotiation between two states is an example of a direct relationship. A state modifying its behaviours spontaneously and voluntarily to bring them into line with international norms and principles would be an example of a diffuse mechanism.

The two power dimensions can be brought together to generate a taxonomy comprising four distinct types of power, which Barnett and Duvall call compulsory, institutional, structural and productive (Chart 1.1).

Chart 1.1 Barnett and Duvall’s Taxonomy of Power¹⁰			
		Relational specificity:	
		Direct	Diffuse
Power works through:	Interactions of specific actors	<i>Compulsory</i>	<i>Institutional</i>
	Social relations of constitution	<i>Structural</i>	<i>Productive</i>

“Compulsory” and “institutional” power focuses on how actors use their unequal capacities to obtain the behaviours they require or desire from other actors. Barnett and Duvall define “compulsory power” as “the direct control of one actor over the conditions of existence and/or the actions of another”. This is the form of power in which agency plays its greatest role. A state uses this form of power, for example, in the classic realist definition of power: state A gets state B to do what it otherwise would not do. Institutional power “exists in

¹⁰ Ibid., 48

actors' indirect control over the conditions of actions of socially distant other actors".¹¹ The focus of institutional power is the control state A exerts over state B by working through the formal and informal institutions that are independent of those states' control, yet mediate relations between states A and B.¹² In the context of international trade, for instance, state A may be able to persuade the World Trade Organisation's staff to take action against state B, either to limit B's exports or change B's trade policy to open its domestic market to state A's and other states' exporters. What distinguishes compulsory from institutional power is that the former is applied directly by one actor on another, but indirectly in the case of institutional power.

Structural and productive power focus on how states' capacities and interests are shaped. Barnett and Duvall define "structural power" as "operating as the constitutive relations of a direct, mutually constituting, kind".¹³ They argue Marx's capitalist/worker relationship and the World System Theorists' core/periphery states' relationships are examples of these direct, mutually constituting, social relations. "Productive power" is defined as that working "through diffuse, constitutive relations to produce the situated social capacities of actors"; it is produced through "systems of knowledge and discursive practices of broad and general social scope... it concerns discourse, the social processes and the systems of knowledge through which meaning is produced, fixed, lived, experienced and transformed".¹⁴ In sum, it is the power of socialisation. There is no role for agency in this form of power. An example of productive power would be a state that learned through discourse to perceive its interests would be best served by complying with an international regime another state or states created long ago, such as, say, a decolonised state learning through discourse that its interests would be best served through compliance with rules on international postal communications that were agreed by other states long before the decolonised state became independent.

Barnett and Duvall's approach is illuminating, but their definition of power focuses exclusively on actors: how actors are influenced directly or indirectly by other actors' powers or by powers exerted by social structures, institutions,

¹¹ Ibid., 49-50

¹² Ibid., 51

¹³ Ibid., 52-53

¹⁴ Ibid., 55

norms and principles. However, they do not explain the existence and form of international structures and institutions: it is as if these simply appear spontaneously. Consequently Barnett and Duvall do not address the issue of how actors may choose to create or influence the international social structures, institutions, norms and principles. Most states lack the power or ambition to act on structures at this global level, but it is a bread and butter issue for hegemons such as the US or for middling power states who collectively may muster the power to change international structures and institutions.¹⁵ World Systems theorists regard a hegemon's power to change international structures and institutions as fundamental. They argue a hegemon comes to power after winning a 30 year conflict and devotes the first phase of its hegemonic cycle to reshaping the World System's structures, institutions and rules to suit the victor's needs.¹⁶ Liberals too expect a victorious hegemon to change the rules of the game.¹⁷ Realists would expect nothing less.¹⁸ Therefore room must be found in the taxonomy of power to accommodate actors exerting their power over international structures and institutions, and reshaping the international norms and principles that guide states' behaviours.

Strange addressed this need from an international political economy perspective, arguing there were two types of power: relational and structural.¹⁹ "Relational power" describes the power one state exerts over another - broadly equivalent to Barnett and Duvall's "compulsory power". Strange defined her version of "structural power" as "the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises and (not least) their scientists and other professional people have to operate".²⁰ This is a very different from Barnett and Duvall's concept of "structural power" yet, with the aid of a heroic assumption, it may be grafted onto their taxonomy.

¹⁵ European Community states played a leading role in creating the International Criminal Court, as did the EC and Japan in agreeing the Kyoto Agreement on Climate Change. Both structures came into existence despite the hegemonic US' opposition.

¹⁶ See Wallerstein, World systems analysis, 57-58. Arrighi's, *The long twentieth century*, provides a fuller treatment of hegemonic cycles.

¹⁷ See, for example, Ikenberry, *After victory*, which is devoted to the topic.

¹⁸ Gilpin, *War and change*, charts a realist's version of the hegemonic cycle. Mearsheimer, *Tragedy of great power politics*, provides a different realist perspective, while Mastanduno, "System maker and privilege taker", claims a hegemon will continue to tinker with its initial designs for international structures and institutions, fine tuning them on an on-going basis in an effort to sustain its privileged position in the international hierarchy.

¹⁹ Strange, *Casino capitalism*, 67

²⁰ Strange, *States and markets*, 24-25

Strange's concept of structural power must be divided in two to respect Barnett and Duvall's differentiation between exercising power directly and indirectly. One may assume there are two classes of states that will attempt to change international structures and institutions: imperial powers and hegemonic powers. Imperial powers are likely to have the more direct, hands on, relationship with international structures and institutions (which may, after all, operate largely or exclusively within their empires). Thus one could add the category of "Imperial structural power" to Barnett and Duvall's taxonomy to signify the attempt of a Great or Unipolar Power to exert power directly over international structures, institutions, norms and principles in order to shape the institutional and socialisation processes that impact on other states (and itself).

Hegemons have a different status to that of imperial powers. An imperial power rules through direct control of the territories within its empire. It can exercise its power against the will of any state within its empire, or indeed against the will of any multinational institution or structure serving that empire. A hegemon will operate differently because it is aware other states - its followers - have chosen it to lead them. The followers' sense of the hegemon's legitimacy is the cement that binds them to their hegemon. Hegemons must attract followers through their soft power - making other states want to imitate them, as Gramsci's followers argued – and/or through the manner in which they deploy their military and economic hard power. A hegemon's relationship with its followers is more indirect and diffuse than one would expect of an imperial power dealing with the states, institutions and structures within its empire. It would seem appropriate, therefore, to categorise "hegemonic structural power" as the more indirect form of power by which a state seeks to exert its power over international structures, institutions, norms and principles, through which it will shape the socialisation processes that impact on other states (and itself).²¹

Introducing these notions of imperial and hegemonic power as categories by which a state seeks to influence international structures, institutions, norms

²¹ It is evident from this approach to imperial and hegemonic power that a state, when attempting to reshape international structures, may switch strategies from time to time, emphasising an indirect, hegemonic power, approach at times and at other times adopting a more direct, imperial power approach. Indeed, a state may simultaneously adopt the two strategies with respect to different states or regions, as Ikenberry argues has been the case for the US: simultaneously a hegemon for Western Europe and Japan, and an imperialist in its relations with the Middle East and Latin America (see Ikenberry, *Liberal Leviathan*, 66).

and principles require in changes to Barnett and Duvall's taxonomy, arguably rendering it more complete (Chart 1.2).

Chart 1.2 Barnett and Duvall's Taxonomy of Power, Revised²²			
		Relational specificity:	
		Direct	Diffuse
Power works through:	Interactions of specific actors with actors	<i>Compulsory</i>	<i>Institutional</i>
	Application of actors' power to international structures and institutions	<i>Imperial structural power</i>	<i>Hegemonic structural power</i>
	Social relations of constitution on actors	<i>Structuring²³</i>	<i>Productive</i>

The addition of imperial and hegemonic structural power to the taxonomy is conceptually useful, but we need a further innovation. Strange's observation that states seek to influence others indirectly by changing the international structures and institutions in which they operate may usefully be broken down into two parts: "negative" and "positive" structural power. This innovative distinction provides a valuable and illuminating conceptual tool for assessing the competing claims of scholars who attribute the end of the Bretton Woods regime and its replacement to a deconcentration of power away from the US monetary hegemon leading to regime instability, and those who believe these events occurred because of the concentration of (structural) power in the US.

So what is negative and positive structural power? Negative imperial or hegemonic structural power is deployed when a state or states seeks to influence others' behaviours by blocking the operation of existing international structures and institutions or blocking others' attempts to change current

²² Barnett and Duvall, *Power in international politics*, 48

²³ To avoid confusion, I have relabelled Barnett and Duvall's "structural power" as "structuring" power. This is reasonable in terms of their definition of this type of power, by which one group applies power to another, structuring its identity, role and capacities.

structures. Nixon's decision to suspend gold convertibility in August 1971 is an example of the successful use of negative imperial structural power because the US unilaterally prevented the Bretton Woods gold-exchange standard from operating as it had been designed to do. Positive imperial or hegemonic structural power occurs when a state (or states) attempts to create new international structures and institutions or reform existing structures and institutions. Examples of positive structural power's successful use include the US and UK's efforts to create the Bretton Woods international monetary order in 1944 and NATO's creation. It is often easier in international relations to block than build, so one would expect to find more examples of negative imperial or hegemonic structural power being used successfully than positive imperial or hegemonic structural power.

3. Mundell's trilemma

This thesis is about power, not economics. But a grasp of one economic concept enables one to appreciate the inescapable economic constraint on policymakers' order-building options. It also helps one understand how fundamentally policymakers changed the international monetary order during 1969-76. The revolution they achieved was beyond their comprehension.

Mundell argued states might wish to pursue three objectives simultaneously: an independent monetary policy; free capital mobility and a fixed exchange rate.²⁴ An independent monetary policy would in principle give a state control over its inflation rate. Capital mobility would give domestic savers and investors access to world-wide opportunities. A fixed exchange rate would give traders and investors certainty about the present and future value of their international transactions, de-risking them to some extent. All three objectives are attractive. Mundell demonstrated the attempt to pursue all three simultaneously would result in instability, both for the state adopting these objectives, and for the international monetary order in which the state operated. Stability could be achieved only if a state limited itself to choosing two of the

²⁴ Mundell, "Capital mobility and stabilization policy under fixed and floating exchange rates"

three desirable policies. Thus governments faced a “trilemma”. Any combination of two of the three objectives is viable, but any attempt to add the third objective would be destabilising, with one exception.²⁵ Mundell explicitly exempted the US from the trilemma: its ability to issue the world’s main reserve asset gave it a privileged status.²⁶

Why should states be limited to pursuing only two of their three desired objectives? The tensions between the objectives are evident if one assumes a government, say Canada’s, attempts unilaterally to adopt a contractionary monetary policy to curb inflation. (Thus it has chosen to run an independent monetary policy.) Its central bank would increase Canadian interest rates to discourage domestic spending. All other things being equal, the increase in interest rates would attract foreign capital to Canada. This, in turn, would put upward pressure on the exchange rate because demand for Canadian dollars would increase as foreign investors exchange their currencies for Canadian dollars in order to buy interest-bearing Canadian dollar assets. The central bank then faces a choice: it could allow capital inflows to continue, but at the expense of allowing the Canadian dollar’s exchange rate to appreciate; or it could stabilise the exchange rate by imposing controls on capital inflows, limiting foreign investors’ ability to buy Canadian dollars. Thus it would be impossible for the Canadian authorities to pursue both exchange rate stability and free capital mobility while running an independent monetary policy.²⁷

Mundell’s analysis, published in 1963, lacked impact initially. It took time to become widely accepted, perhaps because it appeared in a relatively obscure journal and its implications for policymakers could have been drafted more clearly. It is a tough read and he did little to steer his readers towards

²⁵ The gold standard, for example, was an order in which all states enjoyed free capital mobility and a fixed exchange rate, but only the order’s central state (the UK) could run an independent monetary policy. The Bretton Woods order encouraged a different policy combination: all states were able to run independent monetary policies and fixed exchange rates, but, except for the US, had to sacrifice free capital mobility. The post-1976 international monetary order enables most states to run independent monetary policies in combination with free capital mobility, but they have had to accept floating exchange rates as a consequence.

²⁶ The demand to hold US dollars comes not only from US residents, but from foreign central banks who wish to hold dollars in their reserves and from the private sector abroad, which hoards dollars for transaction purposes and as “safe haven” assets. Thus an outflow of dollars from the US does not necessarily depress the US exchange rate, as would be the case for states that do not issue a reserve currency. The dollar outflow may simply be feeding the rest of the world’s demand for more dollar reserves, publicly or privately held.

²⁷ Were Canada to be pursuing an expansionary monetary policy by cutting domestic interest rates relative to those in the rest of the world, the central bank would have to choose between a depreciating exchange rate or controls on capital outflows.

what are now accepted as his main points. I found no evidence in the archives of his analysis having been absorbed by policymakers in either Washington or European capitals as they negotiated to have their preferred version of international monetary reform adopted during 1969-76. None appeared to realise they faced Mundell's trilemma constraint.

Mundell's trilemma has important implications for international political economy. The accuracy of his analysis and the validity of his trilemma concept can be seen in the international monetary order-threatening foreign exchange market crises of May and August 1971, and the order-breaking crisis of January-March 1973. Foreign exchange markets boiled up because both the US and the FRG attempted to pursue independent monetary policies, fixed exchange rates and enjoy free capital mobility. Mundell's analysis demonstrated the international monetary order could survive the uniquely privileged US pursuing the trilemma's three policy objectives simultaneously, but the order was threatened by the FRG also doing so. The FRG's response to massive dollar capital inflows in 1971 helped open cracks in the Bretton Woods order in 1971. The FRG's response to even larger dollar inflows in January-March 1973 helped smash the Smithsonian Agreement that had been intended to repair those cracks.

Mundell's trilemma concept sheds light on the scale of the changes to the international monetary order implemented during 1969-76. There was quite literally a revolution in states' policy choices - and in the associated norms and principles - not, as some scholars would have it, mere adaptation of the Bretton Woods regime's rules.²⁸ Until March 1973 states combined independent

²⁸ Ruggie, "International regimes, transactions and change: embedded Liberalism in the postwar economic order", 221, examined the question of whether the adoption of floating exchange rates and its legalisation through amendments to the IMF's *Articles of Agreement* constituted regime change or merely an adaptation of the Bretton Woods regime. He failed to perceive the revolution in policy choices made during 1969-76 and concluded there had been changes in instruments (rules), not principles or norms: "embedded liberalism" and the Bretton Woods regime founded in 1944 had been retained, he believed. Cohen too argued there had been no regime change in 1969-76 in his chapter in the volume edited by Krasner, *International regimes*. Keohane also came close to this position, arguing "Although the rules of the Bretton Woods regime were altered in 1971-73, the principles of multilateralism and relatively unfettered capital flows were maintained.... Liberalism, though embedded in the welfare state and limited by state action, persisted" (Keohane, *After hegemony*, 208-209). Keohane ignores the fact that the Bretton Woods regime did not include the principle of "relatively unfettered capital flows": it explicitly permitted IMF member states to adopt capital controls and the IMF expected them to do so to help defend fixed exchange rates. One suspects that, had these scholars approached the question through the prism of Mundell's trilemma, they might have reached a different conclusion.

monetary policies with capital controls and fixed exchange rates. Thereafter the norm shifted as states gravitated toward combining independent monetary policies with free capital mobility and floating exchange rates. Mundell's trilemma concept helps explain why this revolution in states' monetary policy choices proved to be enduring. States had not abandoned the Bretton Woods order for a "non-system" as some influential economists claimed at the time; they had stumbled into a new, neoliberal order that was enduring because it was economically and philosophically coherent.²⁹

The three concepts discussed above, plus my introduction of the novel concept of positive and negative structural power, provide the building blocks for the analysis and assessments in the chapters below. They help one assess the theoretical controversy between scholars who believe the international monetary crisis was caused by a lack of US power, and those who believe it was caused by a concentration of power in the US. They help illuminate the reasons for the US veering between policies of hegemony by consensus and consent, and a more imperial approach to hegemony through attempted domination of allies. And they help explain why the US destabilised the international monetary order and system in pursuit of its security interests.

Interpreting Washington's intentions using these concepts, in combination with evidence from archived British and US documents (including the White House tapes), helps create a new understanding of US international monetary hegemony.³⁰ It enables us to see Washington's efforts to increase US security and power relative to its European and Japanese allies led it to gamble with the future of the international monetary order. The gamble, which depended in part on the US "smashing" European integration, failed.³¹ This failure *accidentally* destroyed the Bretton Woods monetary order based on fixed exchange rates and *accidentally* created in its place a neoliberal international monetary order based on floating exchange rates and free capital mobility.

²⁹ See Williamson, *The Failure of world monetary reform*

³⁰ Perhaps Gowan comes closest to my interpretation in his *Global gamble*, although he asserted the US gambled with the prospects for the world economy by encouraging OPEC to raise oil prices in 1973 in an effort to weaken US allies' economies. My research indicates he was right about the mechanism by which the US attempted to increase its relative power - attempting to use international economic crises to strengthen US relative power, gambling the US would make the fastest and strongest recovery from a crisis - but wrong about the instrument it chose. It was not oil, but money.

³¹ Kissinger's description of the US policy aimed at wrecking Europe's first attempt at monetary union, and European integration itself. This is discussed in detail in chapters 6 and 7.

Irrespective of the economic merits and logic behind such a move, it is clear from the archives Washington never planned for this monetary revolution and never wanted it to take place until President Ford saw the restoration of fixed exchange rates as threatening his election prospects.

Thesis Organisation

The first three chapters provide building blocks for the case study analysis that follows. They introduce: concepts; definitions; international relations theories; the controversy between scholars who support structural power and hegemonic stability theory explanations of international monetary events during 1969-76; and outline the backgrounds and ideological beliefs of personnel in the Nixon and Ford administrations' Foreign Economic Policy Executives. Chapters 4-6 draw on US and British archive materials to analyse US efforts to change the way states behaved in the international monetary system in an attempt to strengthen US hegemony during 1969-73. Chapters 7 and 8, again drawing heavily on archived materials, analyse US efforts to change the international monetary order during 1971-76, initially attempting to create a new order to strengthen US hegemony, only to abandon that effort in 1975. The combination of evidence from archives, my neoclassical realist analytical framework and my conceptual distinction between positive and negative structural power challenge the validity of both structural power and hegemonic stability-based explanations of events during 1969-76 and produce original insights on the period that are policy-relevant today.

Chapter 2 discusses what we mean by "hegemony" – its definition, duration and distributive consequences. It examines the literature on the Bretton Woods regime's collapse and the theoretical controversy the regime's demise ignited: was collapse caused by US weakness or strength? It also airs the issue of the roles of structure and agency in international monetary affairs, which leads to me adopting neoclassical realism as the theoretical framework for my analysis. Chapter 3 examines the composition and ideologies of the US' Foreign Economic Policy Executive: the shifting cast of policymakers who were responsible for managing US economic power during 1969-76.

Chapters 4-8 discuss the end of the Bretton Woods order and system, each chapter focussing on distinct episodes in the international monetary crisis. The first three episodes, chapters 4-6, reflected US attempts to change the behaviours of participants in the international monetary system without seeking permanent changes to the order itself. The fourth and fifth episodes, chapters 7 and 8, were US attempts to change the international monetary order's rules.

Chapter 4 discusses the US' decision to suspend gold convertibility and impose a 10% import surcharge, gambling this would persuade other states to change their behaviours by liberalising their trade policies, appreciating their exchange rates against the dollar, and paying more for US-supplied security. The US was able to suspend convertibility unilaterally, but the results were not what Washington hoped. Chapter 5 examines why the US failed to obtain from other states what Treasury Secretary Connally had demanded: opening their markets to US exports, appreciating their exchange rates (i.e. depreciating the dollar) and picking up a larger share of the West's defence costs. I assess French-led international opposition blocked Connally, while Burns persuaded Kissinger to intervene with Nixon (for foreign policy reasons) to persuade the president to settle at the Smithsonian meeting, gaining less than half of what Connally felt was necessary. Chapter 6 discusses Volcker's attempt to complete the devaluation Connally had targeted. He appeared to have succeeded in February 1973, only to find markets overruled him on the new, fixed exchange rates. Nixon and Kissinger, worried about EEC integration's long-term implications for US hegemony, wanted to disrupt European integration, divide European states and obtain European concessions in the "Year of Europe" security negotiations. They tried to use the international financial turmoil created by Volcker's failed devaluation as their lever to achieve their objectives. Kissinger lured EEC states into generalised floating through adopting a seemingly unsustainable common European currency float against the dollar. He was certain the common float would collapse, resulting in EEC disarray and Europeans blaming each other for failure, weakening Europe's ability to resist the US in the "Year of Europe" negotiations.

Chapter 7 and 8 discusses order-building. The US attempted to change international monetary rules in the C20 negotiations by offering to restore a fixed exchange rate order and gold convertibility in return for new rules on

current account adjustment. On the verge of success, Kissinger intervened to tell Shultz to make delay agreement until Europe conceded what he wanted in the “Year of Europe” negotiations. Shortly afterwards OPEC raised oil prices, imposing structural changes on the world economy. Oil exporters needed to recycle surpluses to oil importing states; oil importers needed capital mobility more than fixed exchange rates. The US reform plan had been designed to tackle cyclical current account imbalances, but OPEC had created enduring, structural imbalances. The C20 abandoned order-building in June 1974; Nixon’s presidency barely outlasted it. Chapter 8 examines how the Ford administration dropped Nixon’s attempt at comprehensive international monetary reform (and withdrew from monetary hegemony in the process); reached *laissez faire* agreements with France on new rules for gold and exchange rates; and brought order-building to a conclusion in 1976.

Chapter 9 presents the thesis’ three main conclusions:

- the US attempted to use its structural power to strengthen its hegemony under Nixon’s presidency, but not Ford’s;
- the US was able to use its structural power to block challenges to its monetary hegemony, but could not use it to advance its hegemony;
- US structural power was limited by the need for legitimacy.

Chapter 2

Theory: Half-past Hegemony?

At 8 pm on 15 August 1971 President Nixon delayed a broadcast of *Bonanza*, the nation's favourite television programme, to give his unscheduled, televised address to the US public. A combative Nixon announced he had instructed his Treasury Secretary to suspend the dollar's convertibility into gold to defend it against international speculators and states refusing to play fair on trade or the costs of their defence.¹ Nixon had pulled the plug on a Bretton Woods regime that was already in crisis, a crisis destined to last until 1976. Suspending gold convertibility – Nixon's first attempt to strengthen US hegemony and power by exploiting the monetary crisis - ignited controversies within international relations scholarship. What did monetary hegemony mean to the US? Were Nixon's actions triggered by US strength or weakness?

This chapter reviews the literature on these topics with the aim of identifying an appropriate theoretical framework for use in addressing my research question: how has the United States leveraged economic crises into its hegemony? I opt for neoclassical realism and use this theoretical framework to inform my argument from chapter 3 onwards. Neoclassical realism encompasses roles for agency as well as structure and, moreover, allows for agency to be driven by domestic political considerations as well as international politics. These considerations are important to my argument.

This chapter is organised in three sections:

- it examines hegemony: how it is defined, its distributional consequences and duration. I will argue hegemony should be defined as a constructivist concept: hegemons are created by the states choosing to follow them. I also argue hegemons are self-interested and will seek to capitalise on their structural advantages: a hegemon should not be expected to be benevolent or indifferent to

¹ Nixon, Public Papers, 886-91

its hegemony's resource consequences. And I argue hegemonies have no pre-ordained duration;

- it explains why I have chosen neoclassical realism as the theoretical framework for this thesis. I will argue a hegemon's first duty is to provide leadership to its followers. This involves agency. The hegemon must decide when it will provide leadership and what form that leadership should take. Domestic political factors help shape such decisions. A hegemon's leadership choices are also taken within a context provided by international structures and the imperatives they impose on states. Thus structures as well as agency are important for understanding hegemonic behaviour. One needs a theoretical framework capable of encompassing both, as neoclassical realism does;
- it addresses the on-going controversy as to whether the 1969-76 international monetary crisis was triggered by US strength or weakness. I will argue developments in 1969-76 cannot be interpreted exclusively in terms of the two main schools of thought on this, Hegemonic Stability theorists who attribute the crisis and its evolution to US weakness, or Structural Realists who attribute it to the US' exercise of its structural power. Both approaches have some explanatory power, but neither explains everything. My concept of structural power comprising positive and negative elements helps identify the contribution each theory makes to understanding Bretton Woods' collapse and replacement.²

² My analysis of the theoretical controversy over the collapse of the Bretton Woods regime exposes, but does not address, a problem in institution (or regime) theory. Scholars advocating this theory claim a hegemon will design and introduce regimes favouring its national interests not only in the present, when its hegemony is at its zenith, but over the longer term when the hegemon can expect its relative power to decline. Institution theorists claim a regime, because it is difficult to change, will perpetuate the privileges and influence the hegemon possessed when it first established a regime. The prospect of enjoying a future stream of benefits from its regime helps explain why the hegemon will invest heavily in establishing a regime, often bearing a disproportionate share of a regime's start-up costs. The hegemon's investment in a regime will enable it to reap "dividends" it might otherwise not have enjoyed in the future as its relative power wanes. The Bretton Woods regime's rules were certainly rigged in the US' favour, as institution theorists would expect. The US Executive Director's vote commanded the greatest weight on the Executive Board and, as if that were not enough, the US gave itself a veto over IMF decisions. Yet the US unilaterally ended the regime, despite having invested heavily in it, in terms of gold and financial and political capital during 1945-68. Clearly a newly-created regime expresses the preferences of the hegemon at the time the regime was created. Equally obvious, a hegemon's preferences may change over time. But does that

Hegemony or Empire?

The US towered over the capitalist world in 1971: it possessed the world's largest military forces and its largest markets for goods, services and capital; it generated one quarter of world GDP.³ But was its role necessarily hegemonic? Lundestad argued the US was an imperial state.⁴ Ferguson, Gowan and Panitch and Gindin, also viewed the US as running an empire.⁵

Empire may be defined narrowly, in which one dominant state has political control over other states' internal and external policies: a formally-constituted empire. Or an empire may be based on informal structures in which one state dominates a hierarchical order - politically, militarily and/or economically - and exerts, in Lundestad's description, "considerable influence" over at least some policy areas outside its home territory.

necessarily mean the hegemony will destroy its regime? After all, most of the costs of a regime (for the hegemon) are incurred when a regime is established. If the regime were subsequently destroyed by the hegemon on cost-benefit grounds, this implies a regime's flow of benefits to the hegemon must be relatively small if they are to be exceeded by the costs of regime maintenance. This is not how institution theorists generally present matters. I do not pursue this point, but it is worth noting there appears to be a gap in institution theory in explaining the circumstances in which it might be reasonable for a hegemon to destroy one of its regimes, in the case of the Bretton Woods, the regime was generally seen as a crucial pillar of the global free market economy the US set out to create in 1945.

³ Numerous authors present data demonstrating the extent of US military and economic dominance in the post-1945. See for example, Nye, *Bound to lead*, 109, and Ikenberry, *Liberal leviathan*, 42, for broad-brush presentations of the distribution of military and economic capabilities among the Great Powers. Kennedy, *Rise and fall of great powers*, 384-527 analyses in depth the US' relative strength in each of the individual components of these capabilities. Note, however, that even the extent of US dominance catalogued by these scholars is insufficient to impress Marxist analyst Wilkinson, who equates "dominance" with "mastery" - and complete mastery at that (Wilkinson, "Unipolarity without hegemony", 143-145). He sets eleven tests a state must pass before its preponderant power can be seen as conferring preponderant influence, mastery and thus, in Wilkinson's opinion, hegemony. Other scholars tend to be less demanding, accepting a hegemon will not always get its own way.

⁴ Lundestad, *Rise and decline*, 92-95. He has taken this view since the 1980s.

⁵ Panitch and Gindin, *Making of global capitalism*, 5-8, see their task as being to analyse "The political economy of American empire"; they support the idea of a "predominantly informal American empire" and examine its "imperial strategies" include creating international institutions that are intended both to bring other states into the US' embrace and oblige them to contribute to the US-led order. Ferguson, *Colossus*, 8-12, has a similar view, criticising those who define empire in terms of one state's direct rule or control over another and argues the US' empire is informal, constituting an "empire by invitation". Gowan, *Global gamble*, vii, argues US has adopted a "US First" policy long before Trump's election and put its weight behind neoliberalism and globalisation to alter "the internal and external environments of states in directions which will induce them to continue to accept US political and economic dominance."

Many scholars, some more convincingly than others, dispute the notion of a US empire, formal or informal.⁶ Schroeder defines empire in terms similar to Lundestad's informal empire definition.⁷ Schroeder, however, adds a telling - and to me convincing - systemic point: whereas hegemony is consistent with the Westphalian system of autonomous states, each regarded as juridically equal in status, rights and obligations, empire is not; it nullifies other states' juridical independence and equality.⁸

⁶ Ikenberry, *Liberal Leviathan*, 71, disputes the existence of a global American empire; his grounds for doing so are unconvincing. He regards empire as characterised by a concentration of sovereignty in one state which imposes its rules on the international order, using coercion if necessary to obtain compliance. He sees a clear distinction between the US, which he describes as a "liberal hegemon", and an imperial power. The latter, in his view, enforces the rules on other states, but not on itself, whereas a liberal hegemon is bound by the rules it has negotiated with other states. Ikenberry does not attempt to square his definition of liberal hegemony with Nixon's unilateral violation of international rules by announcing on 15 August 1971 the US' intention to ignore the Bretton Woods rules it had earlier put in place!

Elsewhere Ikenberry explicitly ducks the opportunity to clarify this point. In *After Victory*, he develops an institutional theory of order formation and applies it to various examples of post-war settlements, including that reached in 1945. A key element in his argument is that a victor's regime-creation and regime-maintenance efforts demonstrate the credibility of the victor's self-denying "strategic restraint". "Strategic restraint", Ikenberry argues, helps the victor dissuade other states from counter-balancing against it. This raises the question of the extent to which the US has practiced strategic restraint since 1945. Many authors have drawn attention to the US' practice of exceptionalism and its routine lack of strategic restraint, including, for example, Brzezinski, *The Choice*, 148: "The US has trouble observing strategic restraint, its self-serving doctrines tend to be applied selectively." He regards this as a particular problem in the economic sphere: "America proclaims the benign and globally-shared benefits of globalisation, but respects its rules mainly when expedient" (Brzezinski, *The Choice*, 135). Ikenberry, however, regards the US as having a good record on strategic restraint post-1945 and discusses other states' complaints about this only briefly: "The dominance of the United States has sparked complaints and resistance in various quarters of Europe and Asia, but it has not triggered the type of counterhegemonic balancing or competitive conflict that might have been expected. Some argue that complaints about America's abuse of its commanding power position have grown in recent years... But such complaints about the arrogance of American power have been a constant minor theme across the postwar period. Episodes include the 'invasion' of US companies into Europe in the 1950s ... (and) the 'Nixon shocks' in 1971 over the surprise closure of the gold window... It is striking that the most pointed European criticism of the United States has not been about coercion or heavy-handedness, but rather about perceptions of American unwillingness to lead" (Ikenberry, *After Victory*, 252-253). This is a surprising interpretation. It fails to examine what happens when a hegemon abandons strategic restraint and destroys one of its regimes, contrary to the main plank in Ikenberry's version of institutional theory. It also downgrades allies' substantive complaints about repeated US bullying and Washington's lack of self-restraint to a "minor theme" in transatlantic relations and, contrary to the evidence in the US and British archives, attributes the Europeans' main criticism to the US' failure to give them leadership. As is documented in chapters 6-8 below, there is some, albeit limited, evidence of an unsatisfied demand for US leadership, but a central point that emerged during 1969-76 is the US offered to lead others in a direction Europe and Japan did not wish to follow.

⁷ According to Schroeder, "From hegemony to empire", 63, empire is "the ability of one organised community to exercise political control over another organised community different from and separate from it, making the former the final locus of decision and authority in central political decisions for the community under its rule....The essence of empire lies in the possession and exercise of political control over a foreign community."

⁸ Aron shared this view. Analysing the international order's structure, he argued "The forces of the political units (i.e. states) are in balance, or else they are dominated by one among

The significance of possessing juridical independence, equality, status, rights and responsibilities is obvious when empire is defined in narrow, traditional terms of direct, territorial control: independence from, and subjection to, an empire's formal, direct control are mutually exclusive qualities. But one state could be under the indirect control of another state that has used its structural power to create international structures shaping other states' behaviours and expectations, as Barnett and Duvall and Strange argued.⁹ To be effective, however, this indirect imperial control requires subordinate states either to be unaware of their status and duped into accepting it - a difficult argument to run when scholars are pointing out such states' position in an informal empire - or aware of their status and consenting to supplying what the imperial power requires of them - in which case we are straight into a situation indistinguishable from the neoGramscian definition of hegemony.¹⁰ Joseph argued convincingly that when structures influence states' policy choices, this is a form of hegemony, not empire.¹¹ Strange argued an informal US empire

them, or else they are outclassed by those of one among them to the point where all the units, save one, lose their autonomy and tend to disappear as centres of political decisions. The imperial state, in the end, reserves to itself the monopoly of legitimate violence." He contrasts this imperial hierarchy with hegemony, in which a hegemon exhibits "the incontestable superiority of one of the units. This superiority is such that the unsatisfied states despair of modifying the status quo, and yet the hegemonic state does not try to absorb the units reduced to impotence. It does not abuse hegemony, it respects the external forms of state independence, it does not aspire to empire. In a system of units jealous of their independence, hegemony is a precarious mode of equilibrium." (Aron, *Peace and war*, 151-152)

⁹ Discussed in chapter 1

¹⁰ NeoGramscians reject the notion of an informal US empire in favour of hegemony. They believe the leading state (or class) has the ability to shape the way others think and behave, but they explicitly attribute to hegemony, not empire, this ability to pull the ideological and cultural wool over others' eyes. See, for example, Go, *Patterns of empire*, 7-8, who puts forward the neoGramscian argument that a state may be a hegemon because of its economic or cultural influences - the US' situation on Go's view; he argues a hegemon need not possess an empire. Go defines empire as "a socio-political formation wherein a central political authority ... exercises unequal influence and power over the political (and in effect socio-political) processes of a subordinate society, peoples or space". Cox, in *Production, power and world order*, also discusses how a dominant class can, through its ideology and culture, persuade its counterparts abroad (and thus the state structures that serve that class' interests) to accept the ideology and culture manifest in the dominant state. Nabers, "Power, leadership and hegemony", 933-937, also adopting a neoGramscian approach to hegemony, argues hegemony and leadership are co-constituted and are used to give effect to the power one state's ideology or culture can have over another's. Nye, in *Power in the global information age*, explores the notion through his concept of "soft power". Brzezinski, *The choice*, 27-28, celebrates the US' success in exporting its ideology and culture. This, he argues, reduces the US hegemon's order maintenance costs because US cultural and ideological influences facilitate consensus-building with other states: their populations want the same things as the US population, put pressure on their governments to deliver them and, broadly speaking, operate on the basis of similar normative parameters in pursuit of them.

¹¹ Joseph, "Hegemony and the structure-agency problem", 127-28

might theoretically emerge in the future, but it had not yet arrived.¹² Cooper agreed, while simultaneously fearing US imperialist ambitions.¹³

I accept Schroeder's argument: the US was not an imperial state during 1969-76, it was a hegemon. But what is hegemony?

Defining Hegemony

A hegemon stands out as a state that has risen above the pack in an anarchic society of states. What defines or explains its hierarchical position? International relations scholarship has produced no consensus on this.¹⁴ All scholars agree hegemony is associated with a concentration of power. Beyond this, views diverge. Scholars propose three competing explanations for hegemony: the hegemon's material dominance; a combination of preponderant power and political will; and a consensus formed by willing follower states. Each has different implications for strengthening hegemony. I therefore need to be clear about my interpretation of hegemony in order to answer the question as to whether the US used economic crises to strengthen its hegemony.

Hegemony definition 1: dominance

Some scholars, mainly from the Realist and Marxist traditions, equate hegemony with one state's dominance over others. In turn, they often associate

¹² In 1989 Strange considered the proposition the US has established a new, informal type of empire through its command of international structures and their impacts on other states. She argued such an empire was becoming possible, but had not yet arrived: "What is emerging... is a non-territorial empire with its capital in Washington DC." (Strange, "Transnational empire", 149)

¹³ See Cooper, *Breaking of nations*, 48-49: "If America is not imperial in the usual sense, it is certainly hegemonic: it does not want to rule, but it does want to control (other states') foreign policy." Cooper goes on to question a paradox at the heart of US foreign policy: the US tells other states to be democracies and run themselves, yet also tells them how they should run themselves!

¹⁴ To discuss hegemony with international relations scholars is to enter the land of the Red Queen, where the word means whatever one's interlocutor says it means. Destradi observes international relations scholars often use the terms empire, hegemony and leadership as if they were interchangeable. She attempts to clarify and define the terms based on international relations theory (Destradi, "Regional powers", 909-25). Her impressive efforts notwithstanding, the terminological confusion continues: my definition of hegemony is close to but not identical with what she defines as "leadership".

dominance with the coercion dominance makes possible. Dominance might stem from military and/or economic material factors; for neoGramscians, it takes the form of ideological and/or cultural dominance.¹⁵ These scholars expect the dominant hegemon to pursue its national interests (at both the system and state levels) within the context of the pressures international structures exert upon it. They expect the dominant state to do pretty much as it pleases, untroubled by other states' sensitivities.

¹⁵ Realists such as Mearsheimer and Modelski attribute a hegemon's dominance primarily to its military power. For Mearsheimer, "Great powers are determined largely on the basis of their relative military capability. To qualify as a great power, a state must have sufficient military assets to put up a serious fight in an all-out conventional war against the most powerful state in the world... It must have some reasonable prospect of turning the conflict into a war of attrition that leaves the dominant state seriously weakened." He links dominance to hegemony: "A hegemon is a state so powerful it dominates all other states in the system". He emphasises the hegemon must be dominant, not just the strongest of the great powers (Mearsheimer, *Tragedy of great power politics*, 40). Modelski has a similar view, arguing the hegemonic "world power" is a state that has temporarily achieved military superiority over others and provides order and leadership to the international system (Modelski, *Long cycles*, 10).

Marxists emphasise hegemony's economic foundations. Building on Lenin's class-driven theory of imperialism (Lenin, *Imperialism: the highest stage of capitalism*) in which capital accumulation abroad and empire-formation are closely intertwined processes, Chase-Dunn argues from a World Systems theory perspective "The rise of a hegemon can be understood in terms of the formation of the leading sectors of core production, the (temporary) concentration of these sectors within a single state, which hence becomes the most economically and politically powerful of the core states. Decline sets in when the hegemon loses the ability to develop lead industries ahead of its competitors" (Chase-Dunn, *Global formation*, 171). Wallerstein defines hegemony as the relatively "sweet but brief" moment when the leading core state enjoys simultaneous superiority in the three main economic sectors: agro-industrial production, commerce (i.e. trade and distribution) and finance (Wallerstein, *Modern world system II*, 38 and 262). He describes the US as the world's hegemon during 1945-90, "precisely this period and no longer" (Wallerstein, *After liberalism*, 176). Frank and Gills, *World system*, 146, see wealth accumulation - not power or order - as the hegemon's main objective.

Acceptance of the economic foundations of hegemony is not confined to Marxists. Gilpin, a neomercantilist realist, agreed economic factors explained US hegemony. He argued in 1981 that dominance, which he equated with hegemony, "requires the existence of an economic surplus" because protecting the international order is not a profitable activity and its costs tend to rise over time (Gilpin, *War and change*, 157). US hegemony, he believed, was underpinned by finance, and in particular the dollar's international role (Gilpin and Gilpin, *Political economy*, 134). Structural Realist Seabrooke, *US power in international finance*, 78, follows a similar logic, as does Marxist Gowan, *Global gamble*, viii, both highlighting the "alliance" between Washington and Wall Street in promoting US hegemony.

Other scholars see hegemony being created by a combination of military and economic power. Realist Norrlof attributed US hegemony to its overall preponderance of material resources, the US having the world's largest: GDP; market for imports; military spending; and financial markets (Norrlof, *America's global advantage*, 17-19). Other Realists concur, see: Brzezinski, *The choice*, 148, Kagan, *End of dreams*, 41, and Layne, *Peace of illusions*, 137. They argue US hegemony rests on an overall predominance of power, not any single element of it. Similarly, Marxist Goldstein, *Long cycles*, 5, defines hegemony in terms of "a core state that commands an unrivalled position of economic and military superiority among the core states and is thus able largely to shape the operation of the international system." World System Theorist Arrighi draws attention to Hannah Arendt's observation that a state aspiring to hegemony through an endless accumulation of capital must also aspire to an unlimited accumulation of the power needed to protect its capital (Arrighi, *Hegemony unravelling* - 1, 29). Indeed, most Marxists acknowledge some part of a hegemon's economic surplus must be devoted to protecting its assets' security, implying a hegemon must develop strong, even dominating, military power to complement and safeguard its economic power.

Hegemony definition 2: combining preponderant power and political will

Hegemony through dominance is a structural explanation for hegemony: the hegemon's actions are determined by the impact of structural imperatives on the hegemon's pursuit of its national interests. ("Structure", in this sense, refers to the framework of international order within which states must act.¹⁶) Agency has no role. If there were scope for agency, a purely structural theory that equates hegemony with a state's possession of dominant power would be inadequate. If agency mattered, we need to understand the political choices facing the leading state when using its power.

Many scholars argue a concentration of power (measured in terms of material capabilities) is a necessary but not sufficient condition for hegemony. The state in which the material resources are concentrated must also summon up the *will* to use its capabilities by intervening on the international stage. These scholars see hegemony as a combination of power *and* political will: structure *and* agency.¹⁷ They differ among themselves about the details of how

¹⁶ The four key structures affecting the US and its partners in 1969-76 were:

- anarchy - there was no global government of the international system;
- bipolarity - the US and USSR played the leading roles in the capitalist and communist worlds, respectively;
- power was concentrated in a handful of states. Military power was concentrated in the US, USSR and China, and economic power in the US, Japan and western European states. The US was preponderant militarily and economically in the capitalist world. The USSR dominated the communist world; and,
- various issue-oriented regimes, some capitalist, some communist, shaped their member states' behaviours and expectations in the relevant issue area.

¹⁷ Bergsten, Keohane and Nye, *International economics and international politics*, 14, define a hegemonic system as "one in which one state is able and willing to determine and maintain the essential rules by which relations among states are governed." Unsurprisingly, Keohane and Nye, *Power and interdependence*, 44, remain close to this definition: they regard a hegemonic system as existing where "one state is powerful enough to maintain the essential rules governing interstate relations and is willing to do so." Keohane, *After hegemony*, 34-35, remains wedded to it, emphasising that a hegemon must have "a preponderance of material resources" and the political will to activate its power and exert leadership. Joffe provides a more colourful version of this definition of hegemony, likening international relations to a visit to a casino: "In a casino anybody can play - even with white, one-dollar chips, be it at the roulette or blackjack table. To play for larger stakes, he'll need the purple (\$500) or grey rectangular (\$5,000) plastic. To score in the global power game, a would-be winner needs more than a handful of chips. He must come armed for the long haul, and then with many different chips that fit many games and tables. Out in the real world, the games are military, commercial, financial, diplomatic and cultural; the tables are local, regional and global. Riches are not enough. A nation must *want* to play, that is bring a keen sense of global interest or, even better, global responsibility to the contest... A would-be winner must also be able to compete" (Joffe,

the powerful state should act to be considered hegemonic, but all insist a hegemon must perform various order-creating and order-maintaining functions. These scholars, mainly Liberals, argue the hegemon prevails by using a combination of persuasion, incentives (both carrots and sticks) and coercion to impose its will on other states.¹⁸

This definition of hegemony, by introducing agency alongside structure as a driver of the leading state's policies, is more plausible than the suggestion structural imperatives alone determine the leading state's choices. After all, presidents Carter and Reagan faced essentially the same structural conditions, yet made very different security policy choices: agency matters. Their policy choices were informed by structural imperatives, not dictated by them.

Incorporating agency alongside structure enriches the definition of hegemony. Is this sufficient? I think not. Hegemons deliver leadership. There cannot be a leader without followers. Consequently we need to understand something about "followership" when defining hegemony.

Hegemony definition 3: leadership by consent

Some Constructivist scholars, including Clark, Lebow and Reus-Smit, draw inspiration from the original Greek concept of hegemony as "leadership".¹⁹ They stress domination is not the same as leadership; consent and legitimacy

Myth of America's decline, 224). Layne, *Peace of illusions*, 2-4, believes hegemony involves a combination of power, polarity, ambition and political will.

Ikenberry, in "Institutions, strategic restraint and the persistence of America's postwar order," sees the leading state's choice of grand strategy as the most important expression of its political will to act as a hegemon. He argues a dominant power must make a choice between dominating the international order, abandoning international engagement (as the US did after 1918) or converting its material advantages into a durable, liberal, hegemonic order - the course he claims the UK adopted in the 19th century and the US after 1945. In Ikenberry's view, maintaining a legitimate liberal order requires the hegemon to exhibit "strategic restraint", i.e. forswear domination and abandonment, and create opportunities for less powerful states to influence the manner in which the hegemon creates and maintains its liberal order. Posen, *Command of the commons*, 44, like Ikenberry, argues the US' preponderant military power puts Washington in the position of being able to choose its Grand Strategy from a range of hegemonic policies, but Posen adds a caveat: the US cannot choose from the full range of policies because at least one option, dominance ("primacy" in his terminology), cannot be achieved with the resources the US is prepared to devote to military power.

¹⁸ See, for example, Ikenberry, *Liberal Leviathan*, 55

¹⁹ Clark, *Hegemony in international society*; Lebow, *A cultural theory of international relations*; and, Reus-Smit, *American power and world order*. See also: Clark, *Legitimacy in international society*, Franck, "The Power of legitimacy"; Hurd, "Breaking and making norms"; and, Rapkin and Braaten, "Conceptualising hegemonic legitimacy".

matter to both leaders and followers. For these Constructivists, a hegemon is a state other states have freely chosen as their leader. Thus the role and title of “hegemon” is one that can only be bestowed on a state by others. It can only be bestowed willingly, not through coercion. A powerful state cannot simply assert its hegemony over others because, without their willing consent, the claim would lack legitimacy.²⁰ On this definition, hegemony is a social construct, not a manifestation of a structural concentration of power or a combination of concentrated power and political will.²¹

Accepting these arguments, in combination with my belief that both agency and structure are important, I define a hegemon as a state that:

- has amassed an unusually high concentration of power (as defined by material capabilities) such that it is able to create and maintain the international order;
- can, when it wishes, summon up the will to use its power to establish and maintain international order; and,
- is freely recognised by a wide range of other states as their legitimate leader.

This is a very different version of hegemony from those defined in terms of dominance or the combination of concentrated power and political will. Whereas the latter definitions focus on the *supply* of hegemony, a Constructivist “hegemony by consent” definition also encompasses the *demand* for hegemony. In supply-driven versions of hegemony, subordinate states have no choice: the hegemon supplies international leadership whether or not subordinate states want it. In the case of hegemony through dominance, international structures determine the status and behaviours of the hegemon and subordinate states alike.²² In the case of hegemony through concentrated power and political will, the leading state, whether acting benignly or coercively, unilaterally chooses to assert its authority over subordinate states; again, the

²⁰ This point is made strongly in Finnemore, “Legitimacy, hypocrisy and the social structure”, 69

²¹ Clark, Hegemony, 27, stresses hegemony is “socially bestowed, not unilaterally possessed”. Hurd, “Breaking and making norms”, and Reus-Smit, American power, are of the same opinion.

²² Change can only come about through changes in international structures that erode the dominant state’s power.

latter have no choice, while the leading state has the choice only as to when it will act, not whether it will be the state undertaking hegemonic tasks.

Hegemony by consent presupposes there is a demand for international leadership and states are prepared to accept a subordinate position to obtain it from another state. Subordination is the price - or at least part of it - the follower states are willing to pay to obtain leadership services from the state they choose as their hegemon. What, then, determines their choice of hegemon? This will depend on structural and agential factors. States that feel their security threatened are likely to select a hegemon able to protect them. Economically weak states are likely to choose an economically powerful state as their hegemon in the hope of benefiting from resource transfers from it and access to its prosperous domestic markets. In addition to respect for military and/or economic prowess, admiration of the powerful state's ideology and its cultural and educational practices may reinforce the subordinate states' confidence in their choice of hegemon, a point neoGramscians would echo. Thus a structural concentration of military, economic and "soft" power in one state is likely to make it attractive to a wide range of other states seeking a hegemon to provide them with leadership services. Agential factors will also be involved. Subordinate states will seek a hegemon that broadly shares their objectives and policy preferences. And they will look at a potential hegemon's conduct in international relations: does it consult? When it does, does it listen and adapt its behaviour accordingly? Does it seek to build an international consensus using legitimate means to generate legitimate outcomes?

Gaining legitimacy will usually be an important objective for a state wishing to achieve, retain or strengthen hegemony:

- a hegemon's concern for legitimacy, defined as "a set of beliefs about the propriety, acceptability or naturalness of an action, an actor/role or political order", will be a key element in the follower states' choice of their hegemon.²³ A state is unlikely to be selected as a hegemon unless it respects the norms and principles that guide follower states. Like-mindedness is crucial;
- there is widespread agreement among scholars, which I accept, that legitimacy itself is an important asset in international relations.

²³ Brooks and Wohlforth, *World out of balance*, 173

Zakaria argues “legitimacy is power” because it builds trust and support, making it easier for a hegemon to set the international agenda, solve collective action problems and implement its preferred policies.²⁴ Brooks and Wohlforth stress legitimacy is not only power, it is a “force multiplier”, making the hegemon’s use of power more economical, efficient and effective.²⁵ Clark asserts legitimacy helps the hegemon achieve its objectives by helping it build an international consensus.²⁶ Volgy et al believe legitimacy also enhances leadership by helping a government mobilise domestic as well as international support for its policies.²⁷

Being seen as a state that does the right thing in the right way is a substantial asset to a hegemon when building or maintaining its international order, but there is more to legitimacy than this. As Clark points out, legitimacy is not only an enabler, it is also a constraint.²⁸ A hegemon will be constrained to accept the outcome of legitimate decision-making processes as legitimate decisions, even when the issues concerned have been contested vigorously in the course of the decision-making and consensus-building processes. It is a simple matter for the hegemon to accept outcomes of legitimate decision-making processes when these give it what it desired. The real test of a hegemon comes when it does not get all it wants.²⁹ Acceptance of decisions in these cases is especially important for the hegemon’s reputation, and thus its ability to reproduce its hegemony over time. A hegemon accepting a (for it) worse outcome from negotiations than it might have achieved through domination will enhance its legitimacy, signalling not only respect for other states’ wishes, but also respect for the norms and principles that helped shape other states’ attitudes towards the negotiations. Norms and principles, as well as states, possess their own legitimacy in like-minded communities.

International relations are not a one-shot game: a hegemon will therefore aim to buttress its position over time by sustaining its credibility. Establishing international institutions and regimes is important. A hegemon can demonstrate

²⁴ Zakaria, *Post-American world*, 247

²⁵ Brooks and Wohlforth, *World out of balance*, 175

²⁶ Clark, *Legitimacy*, 3

²⁷ Volgy, Corbetta, Grant and Baird, “Major power status”, 10

²⁸ Clark, *Legitimacy*, 4

²⁹ The US’ experience of failing to get all it wanted from the C20 international monetary reform negotiations (see chapters 7-8 below) is one such example.

the *durability* of its intention to operate legitimately by incorporating widely-accepted (legitimate) norms and principles into the design of, and rules for, international regimes and institutions.³⁰ Signalling its intentions' *credibility* requires the hegemon to bind itself to accepting the outcomes of these regimes' and institutions' decision-making processes. This hegemonic pre-commitment to self-restraint underpins Ikenberry's theory of the need for hegemonic "strategic restraint". He argues follower states place great reliance on a hegemon signalling through strategic (self-) restraint it has no plans to dominate or abandon them, and that it will treat them as juridical equals.³¹

The Constructivists' version of hegemony, "hegemony by consent" is an on/off variable. Consent to the leader/follower relationship may be withdrawn by either party at any moment. Thus hegemony need not necessarily wax and wane in line with a state's material resources as in the power-based definitions used by World System theorists. It also implies the leading state may at any moment attempt to switch from hegemony to dominance of its follower states.

Distributional Consequences of Hegemony: The Net Transfers Debate

Scholars differ over the question of hegemony's distributional consequences. Is the hegemon a net beneficiary or a net contributor of material resources to the international community over the long-run? Closely related to this, does the hegemon define its resource transfer (or power) objectives in absolute or relative terms? And what does this imply for the hegemon's behaviour when a crisis occurs in its international order?

There is a broad consensus among international relations scholars of all stripes that a state, on becoming a hegemon, will create an international order which, while being acceptable to its follower states, primarily suits its own interests. This view can be found in the writings of Realists (such as Gilpin and Modelski), Liberals (Ikenberry and Keohane) and Marxists (Cox, Gowan, Arrighi

³⁰ Brooks and Wohlforth, *World out of balance*, 175, go so far as to describe regimes as manifestations of "congealed preferences" with respect to norms, principles and rules.

³¹ Ikenberry develops this theory in "Institutions, strategic restraint and the persistence of American postwar order".

and Wallerstein).³² There is also general agreement the hegemon will provide “public goods” to the international community as part of any order it creates, and the hegemon will buttress its order by creating international structures such as alliances, regimes and institutions.³³

The scholarly consensus breaks down over the question of funding the hegemon-supplied public goods. Three models of public goods cost-recovery have emerged in the theoretical literature:

- the benevolent hegemon, content to fund public goods at all times;
- the coercive hegemon, recovering all its costs from the willing and unwilling alike; and,
- the structurally-advantaged hegemon, recovering more than its costs without resort to coercion.

The benevolent hegemon

This version of hegemony is associated with Kindleberger.³⁴ Walt and other scholars offer qualified support.³⁵ Their version of a hegemon is a state

³² See: Gilpin, *War and change*; Modelski, *Exploring long cycles*; Ikenberry, *After victory*; Cox, *Production and power in world order*; Gowan, *Global gamble*; Arrighi, *Long twentieth century*; and Wallerstein, *World systems analysis*. Gilpin’s view is representative: “Since the Industrial Revolution, two successive hegemonic powers in the global system (Great Britain and the United States) have sought to organise political, territorial and especially economic relations in terms of their respective security and economic interests. They have succeeded in their hegemonic role partially because they have imposed their will on lesser states and partially because other states have benefited from and accepted their leadership... As was the case with pre-modern empires, the hegemonic powers may be said to supply public goods (security and protection of property rights) in exchange for revenue...” (Gilpin, *War and change*, 144-145).

³³ Public goods have two defining features: their consumption can be enjoyed by one state without impairing another’s enjoyment of the good; and, no state can be excluded from consuming the good (i.e. the good cannot be subject to enforceable property rights). The classic example of a public good is a radio or television broadcast: no matter how many people have tuned in to the broadcast, another can be added without impairing the others’ enjoyment of it; and no one with the appropriate equipment to receive the broadcast can be prevented from tuning in to it. International relations scholars apply the term in a variety of ways. For some, such as Kindleberger, *World in depression*, and Gilpin, *War and change*, a hegemon provides a public good in the form of an all-encompassing “international stability” from which all states benefit. Other scholars refer to public goods taking the form of specific and distinct elements of a hegemon’s international order, such as monetary or financial stability, free trade, internationally-enforceable property rights and freedom of navigation.

³⁴ Kindleberger argues “...the international economic and monetary system needs leadership, a country which is prepared, consciously or unconsciously, under some system of rules it has internalised, to set standards of conduct for other countries; and to seek to get others to follow them, to take an undue share of the burdens of the system, and in particular take on its support in adversity by accepting its redundant commodities, maintaining a flow of

providing leadership and international order-maintenance as a service to the international community: the hegemon is motivated by its own interests and those of the states it leads. Free riders are accepted; the hegemon does not use coercion to bring them to heel or extract payments for public goods. Consequently the hegemon makes net resource transfers to the rest of the international community by under-recovering the costs of the public goods it supplies. This hegemon is a net contributor to the international community, even when vilified by other states for practicing “exploitation” or “domination”.³⁶

The hegemon’s generosity initially reinforces its legitimacy in follower states’ eyes, but sustainability becomes a problem. The net drain on the hegemon’s resources will eventually compromise its ability and willingness to sustain the military and economic capabilities on which its power and international order depend. If the hegemon tired of supplying public goods and leadership without adequate compensation, it might destabilise the international order by refusing to supply public goods until new arrangements were introduced.³⁷ Problems might also emerge if follower states believed a net drain on their hegemon’s resources was weakening its power relative to rival states. Followers might calculate that if the trend persisted, it would undermine their hegemon’s capacity to keep order. They might then shift their allegiance to a new hegemon after a perilous period of uncertainty as to which state would best provide them with effective leadership.³⁸

capital and discounting its paper” (Kindleberger, *World in depression*, 28). Elsewhere he distinguishes between domination and leadership, arguing leadership is characterised by the leading state providing public goods, rejecting exploitation of other states and using persuasion routinely, not coercion (Kindleberger, “Dominance and leadership”, 242-43).

³⁵ Walt argued Kindleberger’s thesis was correct under conditions of bipolarity (and multipolarity) where there were credible rivals for system leadership, but he questioned whether this would hold under unipolarity, where the advantages of hegemonic self-restraint would be less obvious to the hegemon (Walt, “Alliances in a unipolar world”, 90).

Pfaff quotes from an article in *The National Interest* in which William Kristol and Robert Kagan comment on US hegemony, stating “The United States does not pursue a narrow, selfish definition of its national interests, but generally finds its interests in a benevolent international order. In other words, it is precisely because the United States infuses its foreign policy with an unusually high degree of morality that other nations feel they have less to fear from its otherwise dominating power” (Pfaff, “Question of hegemony”, 223).

³⁶ “Leadership to provide the public good of stability, properly regarded, misunderstood as exploitation or sniped at by free riders, seems a poor system, but like democracy, honesty and stable marriages, is better than the available alternatives” (Kindleberger, “Dominance and leadership”, 252).

³⁷ *Ibid.*, 251. It could be argued Nixon’s decision to suspend gold convertibility in 1971 stemmed from the US having wearied of carrying a draining hegemonic burden.

³⁸ As happened in the 1930s according to Kindleberger in *World in depression*.

The coercive hegemon

Gilpin argues a hegemon will have no long-run tolerance of states attempting to free ride instead of paying their share of the public goods' costs, if necessary, using coercion to recover its costs.³⁹ This coercive hegemon acts like a tax collector, gathering from the international community the resources it needs to fund its hegemony. This prevents any prolonged net transfer of resources from the hegemon to the international community as a whole; potential rivals for the role of hegemon cannot free ride. Public goods provision is resource-neutral for the hegemon as long as other states are either willing to pay for them or can be coerced into paying. This ought to boost hegemonic longevity, although using coercion could create legitimacy problems.

Legitimacy is a valuable asset. The hegemon will generally wish to protect or enhance its legitimacy unless the costs of doing so outweigh the benefits. A hegemon will not casually jeopardise its reputation for acting legitimately: Constructivist scholars argue it would be very difficult for a coercive hegemon to retain legitimacy.⁴⁰ In their opinion, even though the outcome of a hegemon's coercive actions - sustaining provision of public goods from which all states benefit - would generally be regarded as legitimate, the coercive process by which this outcome is achieved might not. The hegemon's legitimacy might be preserved if a free-riding state were generally seen as acting illegitimately, or

³⁹ Gilpin commented on the tensions between a hegemon wishing to recover the full cost of providing public goods to the international system, and free rider states who, in effect, were attempting to oblige the hegemon to over-pay for the public goods. He argued hegemon defend their position by recovering their costs in various ways (Gilpin, *War and change*, 169). He describes how the US responded to this problem in the 1960s by running trade surpluses and, as they dwindled, printing money to meet US funding requirements for foreign direct investments, development assistance, maintaining US troops abroad and fighting the Vietnam War. Other states were obliged to accept US dollars as long as they wished to remain part of the US' Bretton Woods regime of fixed exchange rates. The US thereby extracted from states benefiting from its international order the seigniorage and credit it needed to finance its hegemony. Other states accepted this "because it was in their economic and security interests to do so" (Ibid., 175).

⁴⁰ Reus-Smit argues hegemon face a paradox: "stable, enduring leadership requires their power to be socially-embedded" in order to obtain low-cost consensual compliance by follower states, while unilateral and coercive action will be socially corrosive, with negative consequences for both the hegemon and its world order (Reus-Smit, *American power*, 6). Clark believes international legitimacy is rooted in shared values and is produced in relationships between states through which a hegemon's leadership is rendered acceptable to follower states (Clark, *Legitimacy*, 3, 240 and 242); coercion would undermine this. Elsewhere he make the case for legitimacy being essentially the opposite of coercion: "Legitimacy denotes an acceptable or authoritative set of political conditions, and is less likely to meet resistance or require maintenance by coercive or other means of inducement" Clark, *Hegemony*, 31).

if other states regarded the hegemon's coercive actions as an appropriate price to pay for its leadership services and the benefits of consuming its public goods. However, the hegemon might find it difficult to persuade other states of this. NeoGramscians alone would see little difficulty for the hegemon here: in their eyes hegemons are coercive by their very nature and have a talent for pulling the wool over others' eyes.⁴¹

The structurally-advantaged hegemon

Norrlöf sees hegemony as a profit centre. She argues a hegemon creates for itself - through the international order it builds - structural advantages, enabling it to more than recover its costs of supplying public goods, thereby enhancing its power.⁴² It captures the benefits of co-operation without having to resort to coercion.⁴³ The hegemon reinforces its position by extracting resources from the rest of the international community, reinvesting them in boosting its military or economic power, or raising its population's level of consumption. The hegemon benefits because, to the extent other states accept the hegemon's overall international order as legitimate, they are also likely to accept the order's cost-recovering, resource-extracting procedures.

⁴¹ Cox observes: "Dominant groups have coercive power, but they do not need to exercise it because the subordinate readily acquiesce in their dominance as being the natural order of things. In a hegemonic situation dominant forces are prepared to make concessions when necessary to maintain the acquiescence of the subordinate: 'hegemony protected by the armour of coercion' in Gramsci's words." (Cox, "Review", 260)

⁴² Norrlöf claims the US benefits from its hegemony "most of the time" because it has created structural advantages for itself in the areas of "trade, monetary relations and security affairs" (Norrlöf, *America's global advantage*, 11-12). Its structural trade advantage derives from the US possessing the world's single largest GDP and market for imports, access to which is conditional on satisfying various US requirements. The dollar's reserve currency role gives the US structural advantages in the monetary and financial spheres: it can pursue its preferred monetary policies "without facing any of the negative consequences that any other country pursuing the same course of action would have to face", i.e. the US faces no balance of payments constraint on its policies. And its military power has guarded US assets abroad and helped attract foreign investors to a "secure" US (Ibid., 28-29).

⁴³ Ibid., 14. However, note also that Norrlöf has a somewhat odd view of coercion. She claims a hegemon is not acting coercively if it captures rents from states benefiting from the public goods it produces, even if the states themselves are unwilling to pay rents to the hegemon. She regards this form of resource extraction as akin to a user charge, not an unwilling payment of tribute. Norrlöf's interpretation might be disputed, for instance, by some non-US financial institutions and companies that undertake activities which are legal in their home jurisdictions yet are nonetheless required to pay large fines to the US for breaching its regulations and laws (over US sanctions and money laundering rules, for instance) in order to retain access to US markets. Zarate's, *Treasury's war*, discusses in detail the US' lucrative, punitive regulatory outreach.

The hegemon enjoys net resource inflows from the international community; these are seen as legitimate by most states supplying the resources. Some rival states may complain, either because they do not accept the hegemonic order's legitimacy or because they dislike elements of it, such as being obliged to make payments to the hegemon when they would prefer to free ride or under-pay. But most states will swim with the tide, especially if the benefits of the public goods they consume outweigh the costs of their payments.

I find Norrlof's argument more compelling than Kindleberger's benevolent hegemon or Gilpin's coercive, cost-recovering hegemon. Her approach helps explain why it would be in the national self-interest of a rational, resource-constrained state to compete for and, if successful, take on the hegemon's role of providing potentially costly global leadership and order-maintenance services. Norrlof's hegemon not only covers its costs, it profits from its role, an important consideration when having to sustaining hegemony against rivals' challenges. This helps persuade the hegemon's domestic population its sacrifices in pursuit of global leadership are worthwhile. A profitable hegemony is compatible with a durable hegemony, unlike Kindleberger's or Gilpin's versions. The rate of profit would, of course, have to be kept to a reasonable level; followers would desert a hegemon seen as an exploitative, illegitimate monopolist. That risk should usually constrain a greedy hegemon.⁴⁴

The hegemon's target: absolute or relative gains?

The long-running debate between Liberals and Realists about the appropriate choice of target is relevant to the distributional consequences of hegemony: should the hegemon pursue absolute or relative gains? ⁴⁵ Arguably it is a false choice: a hegemon should pursue both, but in different issue areas.

⁴⁴ From his US perspective, Ikenberry discusses follower states' fears of being abandoned by their hegemon, but a hegemon too will fear abandonment by its followers and its profitable international order being undermined by the consequent collapse of its alliances and international agreements.

⁴⁵ See the various contributions to Baldwin's *Neorealism and neoliberalism* for a flavour of this debate, notably those by Baldwin himself, Axelrod and Keohane, Grieco, Snidel and above all Powell, "Absolute and relative gains in international theory", 229, for a discussion of the issue from a hegemon's perspective.

Hegemons will pursue national security and prosperity objectives, seeking power in both areas. Lake argues the two objectives are different by their very nature: military and political power are sought within the context of a zero sum game, economic growth and power are not.⁴⁶ Fungibility between the two issue areas is possible, but limited. A hegemon may therefore pursue relative gains in the military sphere and absolute gains in most aspects of the economic sphere – including the monetary sphere relevant to this thesis – without its policies being contradictory. Powell observes it is sensible for states to pursue both relative and absolute gains in the different issue areas: states must be wary of their security and survival in an anarchic international system; they must therefore be concerned about relative gains where there is a possibility of force being used against them by states making greater gains than

This debate informs the question of whether the hegemon is correct to create a free trade regime as one of its public goods. Liberals, from Adam Smith onwards, argue free trade is an appropriate policy for a hegemon not only because it creates larger absolute gains than protectionist alternatives in the short-term, but also because it provides the best opportunity for maximising economic growth, notwithstanding the similar opportunities free trade creates for the hegemon's rivals. Stein addresses the absolute/relative gains from trade from the hegemon's perspective, observing that both the UK in the nineteenth century and the US in the twentieth century opted to pursue absolute rather than relative gains from trade, although neither were as committed to unrestricted free trade as is commonly assumed (see Stein, "The hegemon's dilemma", 384-385). In some ways the British and US choices are not surprising, even from a relative gains perspective. As neomercantilist Gilpin argues, economic growth stimulated by free trade helps keep the hegemon ahead of its rivals, which is important because states that are relatively rich (as hegemons tend to be) and have fast-growing economies are best placed to afford to make relative gains in military power by building and enhancing their military capabilities using the latest, and generally most expensive, military technologies (see Gilpin, *War and change*, 138). This observation enables Gilpin to argue there is no necessary conflict between a hegemon simultaneously achieving relative and absolute gains as a result of adopting free trade policies.

Many Marxists would support Gilpin's argument, which underpins an early and influential Marxist theory of imperialism in which freedom of trade and capital movements strengthen the leading capitalist states' economies and power at the rest of the world's expense (see Lenin, *Imperialism, the highest stage of capitalism*). The World System theory branch of Marxism is, however, ambivalent on the point. Arrighi and Silver, for example, expect a hegemon, as each sector of its economy reaches maturity, to reallocate resources from low to higher profit uses, both in terms of reallocating capital geographically and across economic sectors (Arrighi and Silver, *Capitalism and world (dis)order*, 264). Investments by the hegemon in rival, developed core states would result in absolute gains for the hegemon, but relative gains in economic power for the rivals. By contrast, investments by the hegemon in the under-developed peripheral states will, in accordance with dependency theory, reinforce the economic and power inequalities favouring the hegemon, delivering to it absolute and relative gains. Wallerstein supports Arrighi and Silver's view (See Wallerstein, *Modern world system II*).

Most Realists do not share the World System theorists' ambivalence: they argue free trade is contrary to a hegemon's interests (see, for example, Krasner, "State power", 318-322). For Realists, free trade allows all poorer and technologically backward states, including the hegemon's main rivals, to initiate a process of catching up with the hegemon, eroding its relative economic and technological advantages. The hegemon might enjoy absolute gains from free trade, but most other states will enjoy relative gains at the hegemon's expense; this explains why, on the whole, they acquiesce in the hegemon's demands for trade liberalisation.

⁴⁶ Lake, "Leadership, hegemony and the international economy", 471

themselves; where use of force is not a consideration, as in most aspects of the economic domain, then state security and survival considerations are irrelevant.⁴⁷ The state can risk pursuing absolute gains through co-operation with other states without fear of the consequences when other states' absolute gains exceed its own.

Where the hegemon's security and economic objectives risk coming into conflict, priorities will be established within the hegemon's decision-making hierarchy. The outcome, a decision to pursue relative or absolute gains, cannot be pre-determined by international relations theory. It will be an empirical matter, with the hegemon's policy makers balancing risk against reward. This observation is relevant to my thesis because it helps explain why the US was willing to set aside its policy of co-operation on international monetary reform – even at the very moment in September 1973 when co-operation appeared to be about to deliver international agreement on the reforms Washington had sought – and attempted instead to achieve relative gains for itself in the security domain by holding progress on monetary reform hostage to European negotiators offering concessions on the US' security agenda.⁴⁸

Implications for a hegemon's reaction to a crisis

Does hegemony theory provide a steer as to how the US hegemon might react to a crisis in the international monetary order? The three competing versions of hegemonic behaviour - the hegemon as a net resource contributor to the international community (Kindleberger), resource-neutral (Gilpin) or a net beneficiary (Norrlof) - have very different implications for the hegemon's likely reaction to a crisis within its order, so selecting the appropriate version of hegemony is important if theory is to inform one's expectations of US hegemonic behaviour in the international monetary crisis of 1969-76.

Kindleberger is explicit on this.⁴⁹ He argues his benevolent hegemon would act to stabilise matters in a crisis by leading the response and taking on

⁴⁷ Powell, "Absolute and relative gains in international theory", 229

⁴⁸ The US decision to subordinate the policy of pursuing absolute gains in the monetary sphere to a policy of pursuing relative gains in the security sphere is discussed in chapter 7.

⁴⁹ Kindleberger, *World in depression*, 28

“an undue share of the burden”, accepting the consequent stabilisation costs as an inevitable part of the hegemon’s job. When the international system needs stabilising, the hegemon has to be its stabiliser: *noblesse oblige* elevated to the level of Great Powers. Only a drained hegemon, tired of its burdens and unwilling or unable to continue to carry them would act otherwise. In this case, as in the 1930s, a crisis could continue unchecked.

Gilpin’s coercive hegemon would think twice about acting as stabiliser. If, say, one of the hegemon’s regimes experienced a crisis and the hegemon had a reasonable expectation it would be able to stabilise the regime *and* run it on a cost-recovery or profitable basis in the future, then a “rational” coercive hegemon would rescue its crisis-hit regime. The hegemon would do whatever it took to stabilise the situation. But if the hegemon believed the regime, even if stabilised, could only be run at a loss in the future, then it would be more likely to cut its losses either by reforming or replacing the “defective” regime.

Norrlöf’s structurally-advantaged hegemon might act similarly. If stabilising and rescuing a crisis-hit regime were to jeopardise the hegemon’s structural advantages to the point where the hegemon might have to become a net resource contributor to the international community, then the hegemon might attempt to ensure full cost-recovery from the regime through its reform or, if a return to full cost-recovery were unlikely, its replacement.

One’s expectations of a hegemon’s response to a crisis threatening its international order depend crucially on whether one believes a hegemon to be altruistic and benevolent, or self-interested and rational. I believe a hegemon would probably be self-interested and rational in a crisis, although it might present its response as altruistic and benevolent. I therefore expect a hegemon to respond to a crisis first and foremost by protecting its national interests. These would include its foreign policy interests in sustaining an effective and legitimate international order supporting its hegemony, as well as its material interests so as to avoid its regimes becoming a net drain on its resources and power. One would therefore expect the US to seek a resolution to the 1969-76 international monetary crisis by ensuring any reformed or replacement monetary regime reflected US preferences and, moreover, did not impose

absolute or relative costs on the US.⁵⁰ I would not expect the US to pursue an altruistic and possibly costly resolution. President Kennedy's pledge that the US would be willing to "pay any price" and "accept any burden", seemingly an endorsement of Kindleberger's theory of hegemonic benevolence, was fine rhetoric, but has never been US policy.

Hegemony's Duration: A 120 Year Lifespan?

My research question is based on an assumption: that the US had a choice as to whether it would make the effort to strengthen its hegemony, thereby lengthening its duration (or rendering it more effective). Scholars who believe there are hegemonic cycles of relatively fixed length would challenge this. These scholars – adherents of Wallerstein's World System theory or Modelski's Realist cycles – would argue any such effort would not be worthwhile because a hegemon cannot change the course of its hegemonic cycle.⁵¹ In their view, a hegemon is destined to follow a well-trodden, inescapable cyclical path that lasts approximately 120 years.⁵² Their theories suggest the duration

⁵⁰ Net of benefits.

⁵¹ World System theory was first developed by Wallerstein in which, *inter alia*, he combined Marxist theory with dependency theory and monopolistic competition theory (for a concise statement of his theory see Wallerstein, *World systems analysis: an introduction*). Other scholars took up his ideas and developed them, notably Arrighi in *Long twentieth century*, Arrighi and Silver, "Capitalism and world (dis)order", Chase-Dunn, *Global formation*, and Frank and Gills, *The world system*

Modelski, a Realist, accepted many of the main ideas in World System theory, including its depiction of cycles and the notion of a hegemony lasting 120 years as he reinterpreted World System theory's insights into a Realist form. He set out the similarities and differences between his "long cycle" theory and World System theory in Modelski, *Exploring long cycles*, 13. Modelski collaborated closely with another Realist, William Thompson, on Realist cycle theory (see, for example Modelski and Thompson, *Leading sectors*). Modelski argued the international redistribution of military power was the hegemonic cycle's main driver, not Kondratieff Waves or the economic factors favoured by Marxists (Modelski, *Long cycles*, 10).

Like World System theorists, Modelski located the US in the early 1970s as being on the point of moving from a phase in which US power was at its peak to one in which its relative power had begun to decline and the demand for the type of international order the US offered was beginning to wane (Modelski, *Exploring long cycles*, 222-24): "The partial erosion of US leadership reflects the feeling that its original program, the consolidation of post-war order, has been successfully accomplished and the time has come to explore new problems and challenges that might, or might not, require a change of leadership."

⁵² Arrighi and Silver call the four, 30 year phases of the hegemonic cycle New Hegemony, Hegemony, Hegemonic Crisis and Hegemonic Breakdown (Arrighi and Silver, "Capitalism and world (dis)order", 270). In the cycle's first phase, New Hegemony, a state claims hegemonic status by virtue of winning a 30 year global war. This period coincides with the start of a Kondratieff wave, which the hegemon rides to achieve world leadership in the three main economic sectors: agro-industrial production; commerce and trade; and finance.

of a state's hegemony is defined by (and limited to) the length of two economic "Kondratieff" Cycles (each lasting about 60 years), during which the hegemon's role will evolve through four distinct phases, each about thirty years in length, starting with the state's successful bid for hegemony through winning a global war.⁵³ Given that a state's progression through the hegemonic cycle is pre-ordained – victory in a 30 years global war followed by 30 years of ascendancy, then 60 years of progressive relative decline before entering a new global war – why would a hegemon waste effort and resources on strengthening its hegemony? It cannot deviate from the path history has marked out for it. It

In second phase, Hegemony, the victorious states uses its new status to impose its preferences on global structures, shaping the operation of the international system by imposing and enforcing its own order. This enables the hegemon to enjoy economic supremacy. However, this phase also coincides with a downturn in the hegemonic cycle's first Kondratieff wave, making it increasingly difficult for the hegemon to sustain its economic superiority over industries in competitor states.

In the third phase, Hegemonic Crisis, the hegemon's leadership is compromised by its inability to sustain monopolistic and quasi-monopolistic leadership of the three key economic sectors, despite a new Kondratieff wave creating a global economic upswing. Maintaining order becomes increasingly difficult for the hegemon as its rivals gain power and confidence from their economic gains relative to the hegemon's economic power.

The fourth and final phase of the hegemonic cycle, Hegemonic Breakdown, coincides with the second Kondratieff Wave's downturn and is thus a difficult economic period world-wide. Rival states muster the military and economic power and resources they will need to challenge the hegemon over a 30 year period. As they do so, the hegemon's authority over its global order gradually evaporates and, as its order disintegrates, the scene is set for another 30 year global war and the emergence of a new hegemon. The former hegemon is then likely to fall back into the ranks of the Great Powers, i.e. states that have the aspiration and global reach to change the international order in their favour, but lack the wherewithal to impose their will and preferences on the new hegemon as it begins to restructure the world order to its own ends.

⁵³ In 1926 Kondratieff, a Russian statistician, claimed it was possible to discern "long waves" of movements in wholesale prices in three capitalist economies (Britain, France and the US), each wave lasting approximately 50-60 years. Each "wave" consisted of a 30 year upswing in prices, followed by a 30 year period of stagnation or decline. He claimed the upswing was associated with a sustained increase in production in the economy concerned, while the second 30 years of price stagnation or decline was mirrored in stagnating or declining production. He speculated these price developments were rooted in technological developments. This was not the explanation Kondratieff's Marxist colleagues wanted to hear: for them, capitalist production crises were caused by social developments and class struggle; nor did they want to hear that capitalist economies had a habit of recovering from production crises. Many analysts have subsequently struggled to come up with the "right" explanation, or at least one more in tune with Marxist theory than Kondratieff had ventured. Berry, *Long wave rhythms*, Goldstein, *Long cycles*, Mager, *Kondratieff waves*, and Marshall, *Long waves of regional development*, survey their efforts and attempt to validate and update Kondratieff's original observation themselves. Their consensus view was that Kondratieff price waves can indeed be detected, but there is no single satisfactory explanation for them. However, when reading their surveys I was struck by the amount of effort - in terms of running the data through arbitrary lags and moving average statistical techniques of varying length - that had to be made to engineer the pattern of price movements Kondratieff claimed to have observed. Nonetheless, World System theorists universally, if not uncritically, accept, *faut de mieux*, national price data trends can be used as proxies for international long-term fluctuations in production and profits and, moreover, these trends are regular and drive the political hegemonic cycle. Wallerstein admits World System theory's reliance on Kondratieff waves is its "Achilles Heel" (Wallerstein, *Essential Wallerstein*, 210-11) and expresses his frustration that statisticians have not yet been able to produce data showing regular international cycles of profits.

should, these scholars would argue, simply accept its fate and the arc of the hegemonic cycle.

I agree with the “Cyclists” that hegemonies do not last forever, but I find the concept of a pre-ordained, fixed length hegemonic cycle unconvincing, primarily because neither the Marxist World System theorists, nor Modelski’s Realist cycle theorists have proposed a credible driving mechanism for their political and economic cycles.⁵⁴ Nor can they explain convincingly why, in otherwise ever-changing international economic and political systems, the only thing that remains fixed is the duration of the hegemonic cycle and its component phases. The historical evidence does not support their argument.⁵⁵

Gilpin proposes a different sort of hegemonic cycle, one driven by the near random impact of technological developments on the international distribution of economic and military power over time. He argued differential rates of technological development in states would cause differential rates of economic growth, resulting in structural shifts in the international distribution of power.⁵⁶ Being driven by a random factor, his cycles are neither unidirectional, nor of fixed duration.

⁵⁴ Marxists do not explain the lifespan of the monopolies that are claimed to underpin a hegemon’s capitalist economies. The existence of Kondratieff Waves is not widely accepted by economists and there has been a notable failure by Marxist statisticians and economists to identify waves that are driven by profits (as they ought to be in a Marxist analysis). This economic driver, so important to World System theorists and to Modelski to a lesser extent, remains little more than a statistical artefact.

⁵⁵ The World System theorists’ version of history is questionable: theorists do not agree how many hegemonies have occurred since 1500 – a fairly basic point; moreover, their claim that a 30 years global war always initiates a new hegemony is contradicted by Europe’s 30 Years War, which occurred in the middle of the Dutch hegemony. Wallerstein argues the hegemonic cycle has turned three times under the modern World System, producing Dutch, British and US hegemonies, initiated by Europe’s 30 Years War, the Napoleonic Wars and the World Wars of 1914-45, respectively (Wallerstein, *World systems analysis*, 57). Arrighi argues there was an additional, earlier, cycle which produced a Genoese hegemon (Arrighi, *Long twentieth century*, 24-25). Frank and Gills go even further, claiming to detect five modern hegemonic cycles: Iberia in the 16th century, Netherlands in the 17th, Britain (twice in succession) in the 18th and 19th centuries and the US in the 20th century (Frank and Gills, *The world system*, 181). As for World Systems theory generating useful predictions, there remains the inconvenient fact that these theorists predicted the US’ hegemony would be in terminal decline by 1990-2010, a period when the US achieved super-hegemony and unipolarity thanks in part to the USSR’s collapse in 1991, a collapse not predicted in World Systems theory.

⁵⁶ Gilpin, a neomercantilist Realist, argued in *War and change* that shifts in the international distribution of power would drive cyclical change in the international system. His explanation of the rise and fall of hegemonies owed much to Walras’ and Marshall’s neoclassical economic models, but where economists saw the price mechanism driving economic change, Gilpin saw shifts in relative power propelling change in the international order and system by creating disequilibria where there was previously equilibrium, requiring changes to be made to restore equilibrium.

Gilpin's model creates roles for agency and structure. Anticipating neoclassical realism, he recognises domestic politics could complicate a state's foreign policy by acting as a circuit-breaker between the international structural imperatives bearing down on a state and the policies it adopts to cope with them. Thus domestic interest groups could exert a possibly decisive influence on a state's resource allocation decisions and its foreign policies, with repercussion on the international distribution of power.⁵⁷

Gilpin's rationalist model is based on the assumption states do not seek to change the international order unless the expected benefits of doing so exceed the expected costs. Political, economic and especially technological developments change states' relative power and constantly alter their cost/benefit calculations (Gilpin, *War and change*, 14). Differential growth rates of states' economic and military capabilities gradually change their interests and their incentives to accept the status quo (Ibid., 14-15). States gaining relative power may seek to add to their territory or achieve additional controls over their environment; states in relative decline must accept a corresponding loss of control. The state emerging as the world's hegemon would have greatest control, but for a limited time only. Its technological advantages would spread to competitor states; other states would produce their own technological advances. The hegemon would also have to deal with a rise in the real cost of military technologies and over-extended international commitments, resulting in a domestic "fiscal crisis": the competing and incompatible claims of domestic consumption, investment and military spending would prompt domestic politics to shift from the "relatively benign politics of growth to a more virulent politics of distribution" (Ibid., 166). The hegemon would retrench - he believed US hegemony had reached this point in the 1970s - and eventually face global war with an aspiring rival for global hegemony. Nothing is certain in Gilpin's model, however, including the length of cycles.

⁵⁷ Whereas a redistribution of power is sufficient to impel states to act in structural Realist models such as Waltz's defensive Realism in *Theory of international politics*, or Mearsheimer's offensive Realism in his *Tragedy of great power politics*, Gilpin is keen to emphasise that a state's decision to challenge the status quo is not simply a mechanistic response to the state's dispassionate recalculation of power relativities: "Power and security are not the only goals of the state..." (Gilpin, *War and change*, 95). In Gilpin's model international structures may facilitate and reward, or impede and punish states adopting certain courses of action; however, they do not *require* the state to act. Domestic factors intervene. Gilpin anticipates the thrust of neoclassical realism by arguing domestic perceptions of foreign policy will have an important role in determining a state's willingness to challenge the status quo: "Whether or not the state makes this attempt depends on domestic factors such as the interests of groups, classes and others in society" (Ibid., 55).

In addition to delivering security, the state must provide welfare for its population and invest some of its resources in creating economic growth. Determining an agreed ranking of priorities and the volume of resources to allocate to them is difficult. Politicians and officials responsible for the state may not always agree with the private sector groups most likely to be affected by the state's preferences: "The most crucial aspect of a domestic regime related to international political change is the relationship between private gain and public gain. How do the growth of power and the expansion of the state affect the benefits and costs to particular individuals and powerful groups in the society? Do private and public interests tend to coincide or conflict? If the growth and expansion of the state and the interests of powerful groups are complementary, then there exists a strong impetus for the state to expand and try to change the international system. If, on the other hand, the growth and expansion of the state imposes a heavy cost on these groups and/or threatens their interests, then a strong disincentive exists" (Ibid., 97).

Gilpin's inclusion of domestic influences on a state's foreign policy introduces an important element of uncertainty by increasing the possibility that states might over- or under-react to changes in international structures. Influential domestic interest groups may not be as fully informed about international developments as is the state through its foreign ministry; they may impose a response on the state for domestic political reasons that is based on

Gilpin's model is neither prescriptive nor, being US-centric, universal in application.⁵⁸ However, it illuminates two key issues for my thesis that are not addressed by other cyclical theories:

- Gilpin's observes hegemony has neither a fixed duration nor follows a pre-ordained path. I agree. It is implicit in my definition of hegemony that it is an "on/off" variable.⁵⁹ A state wishing to retain or enhance its status as a hegemon – as a structurally-advantaged hegemon surely would – is always incentivised to adopt policies intended to prolong its hegemony. So Nixon, a declinist but not a defeatist, was right to reject any suggestion he should passively accept the 1969-76 international monetary crisis as marking the zenith and halfway point of US hegemony and the beginning of its inescapable transition from cyclical ascendancy to decline, as Wallerstein and other theorists contended;⁶⁰

- Gilpin's observations on the importance of domestic politics to a state's foreign policy and the international distribution of power points to the need for this thesis to adopt a theoretical framework allowing both agency and structure to exert influence on a hegemon's policies, and in particular the need to allow scope for domestic political imperatives to over-ride international structural imperatives at times. Neoclassical realism fits this bill.

miscalculation. Thus Gilpin's model not only creates a potentially large role for the domestic influences that were absent from Waltz's "billiard ball" model of states driven purely by structural imperatives, it also creates a significant role for uncertainty and error that were absent from Walras' and Marshall's economic models of perfect competition.

⁵⁸ Gilpin's is not an elaborately theoretical model, rather it is an abstraction created by mapping recent US history onto an adapted version of Walrasian marginalist price theory, with some other historical details blended in (mainly from the UK's experience of hegemony). The model embraces uncertainty and cannot be used to make predictions: Gilpin's forecast of decades of US decline for the US became irrelevant when the USSR collapsed for reasons exogenous to his model. Nonetheless Gilpin was onto something when he examined how military, economic and technological developments cause shifts in relative power that lead to changes in international structures. This in turn exerts pressures on individual states who responded with foreign and security policies crafted in the light of domestic politics.

⁵⁹ Follower states can at any moment change their minds about which state they wish to act as their hegemon. Hegemony therefore does not have the fixed duration or trajectory that World Systems theorists or Modelski claim.

⁶⁰ See, for example, the commentaries on the history of, and the prospects for, the US hegemonic cycle in Arrighi, "Hegemony unravelling", Parts I and II, Chase-Dunn, *Global formation*, 186-188, and Wallerstein, "Future of the world economy", *After Liberalism*, and *Decline of American power*. These scholars interpreted the combination of the US defeat in Vietnam, the US' inability to maintain the Bretton Woods regime and the Soviet Union's achievement of nuclear parity with the US as indicating US hegemony was passing from its second (and final) phase of ascendancy into its first phase of decline.

My definition of hegemony includes a reference to a state “when it wishes, summoning up the will to use its power to establish and maintain international order”. Neoclassical realist theory helps one think about how this might come about.

Neoclassical realist theorists accept most of the assumptions in Waltz’s structural Realist model, but relax his assumption about states being unitary bodies.⁶¹ This permits agency as well as structure to play an important role in their model. In neoclassical realists’ opinion, states are the central actors in an anarchic international system; the international system is the most important influence on a state’s foreign policy over time and changes in a state’s power, or the international distribution of power, will cause foreign policy to change.⁶² A state must aim to achieve security or it will not survive in the long run; but states do not simply respond to international imperatives as in Waltz’s model.⁶³ The state filters international structural pressures through its ruling elite: the state’s foreign policy executive. This executive pursues the state’s interests, but as it does so it must also respond to domestic political pressures because it needs to win and hold power, and to mobilise from within society the resources the state requires.⁶⁴ This implies states with similar characteristics will not respond identically to the same systemic structural pressures on them. Cultural or ideological differences may cause similar states to adopt different

⁶¹ Waltz, in his *Theory of international politics*, developed a “billiard ball” structural model of states’ interactions based on the following assumptions: all states have to perform the same range of functions, i.e. they are considered “unitary states”, and differ primarily only with regard to their material capabilities, not their internal characteristics; international structures - anarchy, polarity (bipolarity in the 1970s) and the international distribution of power (material capabilities) - exert influences on all states in the international system; states respond to the structural influences on them, which explain all the variation in state behaviours, both from state to state at any one moment of time and over time itself.

⁶² “International conditions are real and constraining... This is a crucial realist insight” (Dueck, “Ideas and alternatives”, 231)

⁶³ Kitchen, “Systemic pressures”, 140

⁶⁴ This model of the state is a similar to that used by Marxists Gowan, Panitch and Gindin (see above). Neoclassical realists, however, do not necessarily expect the foreign policy executive to be captured by a single class, whereas Marxists believe a dominant capitalist class will ensure the state acts in its, not the working class’, interests.

foreign policies.⁶⁵ Different internal structures may also cause states of equal power to behave differently when facing the same international pressures⁶⁶.

The transmission mechanism through which international structural imperatives are translated into a state's foreign policy is rendered imperfect by the foreign policy executive's involvement in, and by its concerns for, domestic politics⁶⁷. Thus states may not respond to international imperatives in precisely the way structural Realists using the Waltz model might expect given a state's material capabilities and its position in the international system. Neoclassical realists regard the international system and the international distribution of material capabilities as constituting the dominant influences on a state's foreign policy in the long-run. But they allow for the foreign policy executive to deviate from these policies in the short-run in response to domestic political pressures.⁶⁸ Neoclassical realists expect these deviations from structural Realists' predictions to be no more than temporary and to be "ironed out" through policy corrections over the long-term.

The foreign policy executive's perceptions of international and domestic political pressures are crucial in the short-term.⁶⁹ Its perceptions may change even if international structures and their resulting imperatives remain unchanged: a change in government or a reshuffle of responsibilities within government may alter the foreign policy executive's personnel or ideology, prompting a reconsideration of the state's foreign policy strategy and priorities.⁷⁰ Like Gilpin, neoclassical realists accept a state's ability to respond rationally to international imperatives is clouded by uncertainty so the foreign policy executive's interpretation of information from abroad may change, even if the underlying facts have not.⁷¹ The foreign policy executive receives privileged information about both international affairs and the state's capacity to respond

⁶⁵ Kitchen, Systemic pressures, 129

⁶⁶ Rose, "Neoclassical realism", 147

⁶⁷ Lobell, Ripsman and Taliaferro, Neoclassical realism, 4. Eichengreen and Irwin discuss an example of how this works in relation to US trade policy. They observe that all US presidents since 1945 believed liberal international trading arrangements would benefit the US, but "all bowed to political considerations by accommodating the protectionist demands of domestic interest groups affected by foreign competition" (Eichengreen and Irwin, "Shackled hegemon", 182-84). They claim the need to avoid antagonising politically important domestic interest groups limited the foreign economic policy options open to all US presidents.

⁶⁸ Lobell, Ripsman and Taliaferro, Neoclassical realism, 291

⁶⁹ Rose, "Neoclassical realism", 147

⁷⁰ Dueck, "Ideas and alternatives", 522

⁷¹ Uncertainty is a constant theme in Gilpin's *War and change* model

to external threats and opportunities (information that is not always available to the rest of society), but it cannot know everything relevant to policymaking.⁷² Other states practice deception or act unpredictably; relevant information may not be available at the moment policy decisions have to be taken. This too causes a state's foreign policy to deviate in the short-term from that an omniscient ruler might have selected.

The direction of a state's foreign policy may be clear over the long run, but comprehending its policy choices at any particular moment requires an understanding of both international and domestic politics, as well as the international structural imperatives pressing on the state. Unit level variables will constrain or facilitate state choices.⁷³ A theory incorporating this will be more complex and "realistic" than Waltz's hugely simplified model: Waltz's "billiard ball" states propelled by international structural imperatives no longer simply bounce off each other, they can move of their own accord and in directions of their own choosing. This theoretical approach offers benefits: it facilitates understanding of states' interactions and an appreciation of policymakers' difficulties as they construct foreign policy in an anarchic, uncertain world. These benefits have costs, however. More information is required than would be necessary to apply the Waltz model, including information on domestic politics and the character and ideologies of the people constituting the foreign policy executive. But this is necessary if one accepts, as I do, a purely structural theory would be inadequate to explain US efforts to strengthen its hegemony in the face of international monetary crises during 1969-76: one requires an understanding of structure *and* agency.

⁷² Lobell, Ripsman and Taliaferro, Neoclassical realism, 27

⁷³ A state's institutions affect its ability to extract the resources it needs from society; domestic societal actors and interest groups exert influence on policy choices; the degree of state autonomy from society affects elite cohesion and their range of policy choices (Lobell, Ripsman and Taliaferro, Neoclassical realism, 4). Culture and ideology affect the range of legitimate policy choices available to the foreign policy elite, as well as the urgency with which policies may be implemented (Dueck, "Realism, culture and grand strategy", 204).

Collapse of Bretton Woods: Due to US Strength or Weakness?

The debate rumbles on as to whether the Bretton Woods regime collapsed because the US could no longer support it, or because the US wished to replace it.⁷⁴ Hegemonic weakness or strength?

Hegemonic weakness

Liberal theorists, especially those writing immediately after Bretton Woods' collapse, tended to argue the regime ended because of US weakness (Table 2.1). World System theorists concurred, explaining US weakness as the inevitable consequence of the hegemonic cycle in motion. The early 1970s marked half-past hegemony for the US in cyclical time: US fortunes were turning from a cyclical upswing to downturn, confronting the US with the prospect of losing its leadership in key economic sectors; this would be followed by an erosion of US relative economic and military power over time. Wallerstein claimed to find evidence of the cyclical turning point having been reached in the events of Paris 1968 (a rejection of US-style liberalism in his opinion), the US' failure to prevail in the Vietnam War and the collapse of the Bretton Woods international monetary regime.⁷⁵ US power over the World System had passed its zenith. Arrighi and other World System theorists concurred, as did Realist cyclist Modelski.⁷⁶ The latter argued US military preponderance had ended as the USSR achieved nuclear parity in the 1970s and the Western world had begun to tire of the US' world order, undermining Washington's ability to sustain the international co-operation needed to maintain the Bretton Woods regime.

⁷⁴ See, for example, Clark, *Hegemony*, 125-31

⁷⁵ See especially Wallerstein, *Curve of American power*, 81-85, which elaborates ideas he put forward earlier in Wallerstein, *Future of the world economy*, 175-179, *Essential Wallerstein*, 256 and 262, and his *Decline of American power*.

⁷⁶ Arrighi, *Long twentieth century*, 75-77 and 330-31 and "Hegemony unravelling, II", 111; also: Arrighi and Silver, "Capitalism and world (dis)order", 267-69; Chase-Dunn, *Global formation*, 80-81 and 186; Bornschier and Chase-Dunn, *Future of global conflict*, 43-44; and, Frank and Gills, *The world system*, 104-05.

For Modelski's views, see *Exploring long cycles*, 222-24, and *Long cycles*, 40 and 97-98. Modelski subsequently qualified his views, arguing the US' global leadership was simply "under question" following the USSR's collapse and the need for the international community to fill and repair the "political and ideological void" this had created (Modelski and Thompson, *Leading Sectors*, 223).

Table 2.1 Selected authors' views on the cause of the Bretton Woods regime's collapse			
	US strength	US weakness	Other causes*
Realists	Ambrose (2008) Baldwin (1978) Black (2007) Calleo & Strange (1984) Gilpin (1987) Gowa (1983) Guzzini (1998) Hudson (1972) Kirshner (2003) Kunz (1997) Mastanduno (2009) Seabrooke (2001) Sterling-Folker (2002) Strange (1986) Walter (1993) Whitman (1975)	Joffe (2014) Kindleberger (1981) Krasner (1977) Kwarteng (2014) Modelski (1987b)	Kindleberger & Aliber (2005)
Liberals	Coggan (2012) Eichengreen (2012) Gray (2007) James (1996) Keohane & Nye (1977) Nye (1990) Small (1999) Williamson (1977)	Bergsten (1975) Bergsten, Keohane & Nye (1975) Calleo & Rowland (1973) Cohen (1977) Eichengreen (2008) Kennedy (1988) Keohane (2005) Morse (1979) Nau (1992) Nye (1976) Schmitt (1974) Solomon (1977) Stein (1984a) Versluysen (1981)	Argy (1981) Gilbert (1980) Grauwe (1989) Johnson (1973) McKinnon (1993) Meier (1974) Moffit (1983) Taylor (1995) Triffin (1964)
Marxists	Cox (1987) Gowan (1999) Konings (2009) Panitch & Gindin (2012)	Arrighi (2005b) Chase-Dunn (1989) D'Arista (2009) Wallerstein (1979)	Aglietta & Fernbach (1979)
Other/Not identified	Helleiner (1994) Odell (1982) Reeves (2001) Russett (1985) White (1974)	Clark (2011) Conway (2014) Milner (1998) Odell (1979)	Garber (1993) Webb (1995)

*A diverse set of suggested causes, including class struggle, Bretton Woods regime design flaws, including the assumptions on which the regime was based. Scholars may appear in more than one column because they changed their interpretation of events over time.

Liberal theorists took a different tack, having invested heavily in developing regime and institution theory.⁷⁷ These were sophisticated explanations for the co-operation the US had developed with its allies after 1945. Liberal scholars remained keen on the idea regimes and institutions could promote mutually beneficial co-operation between states while minimising states cheating or free riding. Liberals expected such regimes would not be abandoned lightly, especially by the hegemon that created them. Hegemonic stability theory appeared to explain how and why it was in a hegemon's interest to create and sustain these regimes and their institutions, and why any regime loss or weakening would be attributable not to an actor's policy choices, but rather to structural developments, notably the hegemon's inability to sustain its relative power. This narrative was consistent with two Liberal beliefs: the virtues of co-operation and states' unwillingness to surrender its fruits readily.⁷⁸

In opting for a structural rather than agential explanation as to why a hegemon might destroy a regime it had created, Liberal scholars deflected attention away from a need to re-examine fundamental Liberal assumptions about co-operation, regimes and institutions. Blaming structures rather than a loss of political will in Washington saved Liberals from the need to examine why a liberal, democratic US hegemon might choose to abandon self-restraint and co-operation, and destroy one of its regimes through an act of agency.

Bergsten expressed many Liberal scholars' thinking in his 1975 declinist tract *Dilemmas of the dollar*:

"We are now in ...a period of anachronistic hegemony. US dominance of the non-Communist world is over, both politically

⁷⁷ For comprehensive explanations of institution theory, see: Keohane and Martin, "The Promise of institutionalist theory" and Ikenberry's "Institutions", and, *After victory*, 50-79.

⁷⁸ Ikenberry summarises the assumptions underpinning the liberal view of international relations, including the belief that peoples and governments share a common interest in establishing a co-operative world order based on reciprocity and the rule of law, and that co-operation and collective action can create a stable, open international system in which powerful states will act with enlightened restraint (see Ikenberry, *Liberal leviathan*, 63).

and economically, for both international and domestic reasons. The relative might of the US, though it will remain large forever, will continue to decrease... the dollar simply can no longer play the key currency role it played in the past. ...the US should now actively seek a greater management role in the international monetary system, at least for the countries of Western Europe ... and Japan and some of the most important developing countries (especially the oil exporters). Resistance to the trends leading inexorably in this direction would be folly. ...a reduced international financial role for the dollar may be a necessary concomitant of the reduced world political role sought by most Americans".⁷⁹

Ramming home his "lost hegemony" message, Bergsten asserted "No single country, including the United States, can now manage the (international monetary) system alone."⁸⁰

Liberals tended to accept Bergsten's argument - Bretton Woods collapsed because of US weakness - and were generally sympathetic towards hegemonic stability theory, in spirit if not always its literal interpretation. The basic hegemonic stability idea stemmed from Kindleberger's assertion: the international system needed one powerful state to undertake two core functions: provide public goods for its and all other states' benefit; and act as the system's stabiliser. The hegemon was the state capable of both establishing the system's rules and enforcing them.⁸¹ He regarded a structure, the concentration of power in the hegemon, as conducive to rule enforcement. Keohane developed Kindleberger's idea, suggesting a hegemon's political will to create and sustain order was as important as the material capacity to do so:

⁷⁹ Bergsten, *Dilemmas of the dollar*, 509. Bergsten had been the leading economic adviser on Kissinger's National Security Council staff until his resignation in May 1971, at which point he transferred to the Brookings Institution.

⁸⁰ Ibid., 513. This view may have been more pessimistic about the US' situation and the consequences of US hegemonic decline than that held by some other Liberal scholars, but even Keohane, who argued his formulation of Hegemonic Stability Theory over-predicted the adverse consequences for the international monetary system in the 1970s of US hegemonic decline, nonetheless first published his analysis of the situation in 1984 under the title *After hegemony*.

⁸¹ Kindleberger, *World in depression*, 28. He elaborates on this with respect to US post-war experience in Kindleberger, "Dominance and leadership", 242-43.

agency mattered as much as structure.⁸² In Keohane's view, a hegemon minded to provide stability would use its power to resolve collective action problems and establish regimes and institutions (delivering either public or "club" goods to member states) as the US had done during 1945-71.⁸³

Liberals believe regimes and institutions embody norms, principles, rules and agreed decision-making procedures; these tend to help a hegemon maintain order at minimal cost. Being generally regarded as legitimate by their members, regimes and institutions help shape and constrain member states' behaviours and expectations to those consistent with the hegemon's preferences. Regimes and institutions minimise states' incentives to cheat and free ride, and provided clarity about each member state's behaviour, reducing uncertainty and suspicion in the international system. This also helps reduce the hegemon's order-maintenance costs. It is left to fund order enforcement in issue-areas not covered by regimes or where a regime's incentives were insufficient to restrain discontented states. But successful regimes and institutions ought to ensure states' anti-social behaviour is exceptional. Making order-maintenance dependent on the concentration of power in the enforcer hegemon implies, however, problems would emerge for all states if the hegemon became unwilling or unable (through a decline in its relative power) to enforce order. Hegemonic stability theory predicted instability and crises would ensue: cheating and free riding would proliferate alongside a deconcentration of power, undermining the system's rules and institutions.

Scholars debated the assumptions underpinning hegemonic stability theory, the logic of the causal link between a hegemon's relative loss of power and instability in the regimes it had established, and the magnitude of the effects on systemic stability of any loss of hegemonic power. Could one always

⁸² Keohane, *After hegemony*, 32-39, distinguishes between what he terms the "crude basic force model" of hegemonic stability, in which the hegemon's stabilising influence over the international system is determined purely by its command over material resources, and his own "refined" version, in which the hegemon's will to maintain order is as important as its material capabilities.

⁸³ Club goods are like public goods, except enjoyment of them can be restricted to the states willing to contribute to meeting the costs of their supply. For example, states participating in the GATT and WTO are required to offer Most Favoured Nation treatment on tariffs only to fellow member states. Higher tariffs may be levied on imports from non-member states. Similarly, only IMF member states benefit from the institution's economic advice and balance of payments support loans, and states may only become members if they deposit their "quota" of gold and/or currency with the institution.

assume a hegemon wanted stability?⁸⁴ If the hegemon's preferences changed, might it welcome a period of instability to help bring other states round to its new way of thinking?⁸⁵ Was it the hegemon's role to provide stability through supplying public goods, or might it generate the same stability by providing club goods?⁸⁶ Was regime-creation a hegemon's monopoly, and was stability

⁸⁴ Gowan, *Global gamble*, 21, argued to the contrary: in his view a hegemon had an interest in being a destabiliser at times because this would help it maintain its power advantages over its allies (discussed below). Grunberg, "Exploring the 'myth'", 441, pointed out it was easy for a hegemon to rationalise any of its disruptive or predatory behaviour as being motivated by the need to maintain the international order's stability. This, in her opinion, should not be confused with benevolence because the hegemon had created this order with the intention of benefiting disproportionately from it. She gave examples of what she considered British predatory hegemonic behaviour in the 19th century. Bacevich, *American empire*, 3, provides similar evidence of a destabilising US, arguing the US deploys military force when its security is threatened by states that do not accept the international order should be based on the liberal and free market principles the US upholds.

⁸⁵ Guzzini, *Realism*, 151, criticised hegemonic stability theory for failing to explain when and why a hegemon might change its policy preferences and priorities, in circumstances where international structures either changed or remained unchanged. Krasner provided the answers to Guzzini's question in his "security version" of hegemonic stability theory (see Krasner "US commercial and monetary Policy"). Basing his arguments on US experience of post-1945 hegemony, Krasner claimed a hegemon's preferences were bound to change over time because there would inevitably be a redistribution of power to the hegemon's disadvantage. A state in the early phase of its hegemony might be able to afford to provide public goods to the international system without concerning itself too much about the costs or about free riders making relative gains for themselves at the hegemon's expense. However, as the hegemon's margin of power advantage narrowed over time, it would face two pressures: the burdens of hegemony would rise relative to its economic capabilities; and domestic interest groups would balk at providing the state with the resources it needed to sustain its hegemony. The hegemon might at this point prefer to switch from providing public goods to all states to providing club goods to those states willing to contribute to the cost of their supply. Such a switch would constrain free riders and mobilise resources internationally that the hegemon had found increasingly difficult to mobilise domestically. Krasner believed the switch to providing club goods would probably reduce international welfare. Moreover, the adjustment process might create a degree of instability, but the hegemon might prefer this because its hegemony would be strengthened through this switch to pursuing relative gains in preference to absolute gains. Krasner later termed this a "security version" of hegemonic stability theory, contrasting it with Kindleberger's benevolent version (Webb and Krasner, "Hegemonic stability theory", 184).

⁸⁶ The debate over hegemonic stability theory became somewhat confused at times by scholars' failure to distinguish between the consequences for the international order (and system) of a concentration of power, and the conditions needed to supply public goods to the international system, as noted by Cohen, *International political economy*, 70. Lake, in "Leadership, hegemony and the international economy", attempted to disentangle the issues by separating the debate into distinct discussions of leadership theories and hegemony theories, the latter characterised in particular by the view that a hegemon will always aim to impose liberal trade policies on the international system, as claimed by Krasner in "State power", but contradicted by others, including Stein in "The hegemon's dilemma", and to an extent by Krasner himself because only half of the episodes he examined during 1820-1970 produced evidence consistent with his claim. It appears to me, however, that Lake's "clarification" missed the main point: knowing where power is concentrated tells us nothing about how it will be used with respect to either leadership or hegemony. Ikenberry, in "Institutions, strategic restraint and persistence", is surely correct in arguing that once power has concentrated in a hegemon, it may adopt one of three strategies: domination of the international system; abandonment, i.e. shedding to other states the responsibility for setting and/or enforcing the system's rules; or sharing responsibilities with other states through adopting some measure of self-restraint. The concentration of power in a single state cannot by itself tell us which strategy the state will adopt, not least because domestic factors will play a role in determining which course a

always the result of supply-side factors, or might a strong demand for institutions and regimes persuade other states to step in and sustain them as and when a hegemon faltered?⁸⁷ What was the quantitative relationship between international stability and the hegemon's relative power?⁸⁸ Might stability survive all but the most substantial loss of hegemonic power, or might stability be undermined significantly by even a small relative decline?⁸⁹

Liberals debated but clung to the argument a hegemon was needed to establish regimes and institutions, as the US had after 1945, because the start-up costs would be prohibitive for less well-endowed states;⁹⁰ the hegemon would ensure the institutions/regimes benefited all member states, but above all

hegemon will follow. I believe Ikenberry, in *Liberal leviathan*, was also correct when observing the US had at times adopted all three strategies simultaneously: balancing against the Soviet bloc (i.e. containing the Soviet Union while not attempting to impose its liberal democratic, capitalist order on the Soviet sphere of influence); strategic self-restraint with respect to Western Europe and Japan; and domination over Latin America and the Middle East. Moreover, the balance between dominance, self-restraint and balancing may change over time: President George W. Bush's administration tended to emphasise dominance to a greater extent than some previous administrations, whereas President Obama administration tilted the policy balance towards greater US self-restraint. This suggests one cannot simply assume a state which has amassed a concentration of power will necessarily use it in a particular manner, and nor will its policy configuration remain constant for all time.

⁸⁷ See, for example, Keohane, "Demand for international regimes", Krasner, *International regimes*, Lake, "Leadership, hegemony and the international economy", and Snidel, "Relative gains", in which it is argued a single hegemon is neither necessary nor sufficient to explain the creation and maintenance of regimes. Their arguments appeared to be substantiated by examples such as the UN Law of the Sea, the International Criminal Court (ICC) and the Kyoto Protocol, all of which came into being without US ratification and operate without US participation. However, Gowa, in "Rational hegemons", makes an "economies of scale" argument for a single hegemon creating and sustaining the international structures that deliver system-stabilising public goods. She claimed a single hegemon would be a more efficient and effective provider than an oligopoly of smaller states. In particular, a hegemon would be more likely to undertake rule enforcement actions unilaterally, or organise and lead enforcement coalitions, than would a group of smaller states attempting to co-operate without the hegemon's involvement. The ICC's travails appear to justify her scepticism. Ikenberry, in "Institutions, strategic restraint and persistence", agreed a hegemon was the state best placed to create an order, but, he argued, the hegemon could only sustain its order legitimately if it adopted a policy of self-restraint ("strategic restraint" in his terminology); he argued an attempt to sustain international order through dominance would spur smaller states to undermine and even balance against the most powerful state - an example of destabilising hegemony. Ikenberry's criticism of hegemons who adopted a policy of "abandonment" implied he shared Gowa's doubts about the wisdom of leaving order maintenance to smaller states alone.

⁸⁸ Webb and Krasner, *Hegemonic stability theory*, 183-84, examine the relationship between the US' relative power during 1945-80 and the degree of stability in the world economy. They assessed US relative power declined during 1945-70, but stabilised thereafter. They also assessed the international economic system generally performed well in these periods, with international trade growing faster than domestic production and, despite some increased instability in prices and exchange rates, international financial flows increased dramatically in the latter period.

⁸⁹ Keohane, "Demand for international regimes", 142, complained hegemonic stability theory did not explain the lags between changes in power structures and changes in regimes, nor why some regimes were more durable than others.

⁹⁰ Axelrod and Keohane, "Achieving co-operation"

the hegemon itself;⁹¹ and the hegemon had an incentive to sustain its regimes and institutions. Having paid the bulk of the initial costs when creating a regime or institution, the hegemon would aim to recover more than its sunk costs by reaping a flow of dividends on its initial investment, especially if it had designed the regime or institution in such a way as to benefit itself disproportionately in the future when its relative power might decline, as the US' had in the 1960s.⁹² This implied the hegemon would be most unlikely to undermine unilaterally the international co-operation needed to sustain the regimes and institutions it had created.⁹³ Given the hegemon's overriding interest in reproducing the structural conditions that generate its position at the top of the international hierarchy, a hegemon's failure to support and sustain its stability-creating regimes and institutions would be a highly unusual and significant event.

Liberals' faith in the benefits of co-operation probably predisposed the majority towards accepting the main thrust of hegemonic stability theory - that a hegemon's relative loss of power will probably lead to instability - as the explanation for the increased instability in the international system after 1968 that coincided with the US' relative loss of power. Fundamental Liberal assumptions would be challenged if one blamed instability on states becoming less willing to co-operate. Other scholars were not convinced, however, either by hegemonic stability theory or the assumption the US' relative power had declined to the point where it could no longer get its own way.

⁹¹ Literature on hegemony contains claims modern hegemons create free trade regimes because this "public good" helps boost their exports and economic power. British and US hegemonic support for liberal trade regimes is cited as supporting evidence. Gowa contradicts this claim, stating a rational hegemon's interests might be better served by avoiding free trade and instead imposing "optimum tariffs" (Gowa, "Rational hegemons", 307-08). She argues free trade is not a public good because the hegemon can exclude other states from its free trade area, although enforcing trade rules can be regarded as a public good. Krasner, in "State power", claims the coincidence of open trade arrangements and British and US hegemonies is misleading: Britain's support for free trade continued after its hegemony ended, while domestic political factors caused a lag between the US becoming a hegemon and adopting a free trade policy. Stein, in "The hegemon's dilemma", examined 19th century British trade policy, finding that, as in the US experience, there was a lag between Britain becoming a hegemon and adopting a free trade policy and, moreover, Britain was unable to impose free trade on smaller states except when the latter agreed it was in their interests to adopt it.

⁹² Ikenberry, *Liberal leviathan*, 108, describes regime rules and institutions as a hegemon's "insurance policy" because they help safeguard the hegemon's position over time, securing its future position even as relative shifts in power move against it. Fukuyama, "Soft talk, big stick", 223, was sceptical, claiming a regime or institution could not bind the behaviour of a rising power that saw itself as the hegemon's rival. He argued the most that might be expected was for the regime or institution to socialise the foreign policy elite in the rising power by supporting and rewarding those among the elite who advocated international co-operation.

⁹³ Baldwin, *International political economy*, 509, argued the US' opportunity cost of overturning one of its regimes, such as Bretton Woods, was larger for than any other state.

Hegemonic strength

Strange, Russett and Nye argued the US had lost some of relative power to resurgent economies in Europe, Japan and the USSR, but this relative decline represented a return to normality after the artificially high levels of US relative power in the immediate post-war period.⁹⁴ The US, they emphasised, remained by far the most powerful state and, when it chose to do so, Washington could lead the international system pretty much where it wanted.

Strange, Russett and Nye accepted the US had emerged from the Second World War strengthened to the point where it produced half of world GNP, whereas its main rivals had suffered serious damage to their economies. But, these scholars pointed out, the damage was temporary. The massive power imbalance favouring the US in 1945 was unsustainable. Having completed a 20 year economic recovery, European and Japanese power had returned to a “natural” level relative to the US’ by 1965.⁹⁵ Notwithstanding Europe’s and Japan’s impressive recoveries, the three contrarians argued, the US continued to lead the world in military, economic, financial and soft power. This predominance, in these scholars’ opinion, enabled the US to exploit its position as the world’s most powerful state during 1969-76 and unilaterally replace the Bretton Woods regime with a new structure matching US preferences.⁹⁶ They believed Washington had consciously set aside the “self-restraint” Liberals praised and had activated US structural power to destroy and

⁹⁴ Strange set out her case in “Persistent myth of lost hegemony”. She introduced the concepts of relational and structural power in *Casino Capitalism*.

Russett believed US hegemony had avoided rewarding free riders by providing its public goods as “club goods”, i.e. supplying benefits to other states through international regimes and institutions to which other states had to subscribe to access the benefits. This enabled the US to share the costs of its hegemony: “These gains have helped the United States both to maintain its power base ... and to continue to control outcomes. Specifically, the international system has been structurally transformed, largely by the United States.” This, Russett concluded, enabled the US to transform international preferences and expectations in ways favourable to the US, further reducing the order maintenance costs the US had to pay to sustain its hegemony (Russett “Vanishing hegemon”, 208).

Nye, disputing Kennedy’s warnings of the US suffering “overstretch”, claimed “American leadership is likely to continue well into the next century” (Nye, *Bound to lead*, 22).

⁹⁵ Organski and Kugler, in *War ledger*, dubbed this “the phoenix factor”, observing that Great Powers who had been defeated in wars fought to attain hegemonic leadership often required 20 years to recover their power.

⁹⁶ See Gowan, *Global gamble*, 31: “The whole point of the Nixon moves to destroy the Bretton Woods system and set up the Dollar-Wall Street Regime was to put America first.”

replace the Bretton Woods regime. The latter, some argued, had weakened the US by rendering its exporters uncompetitive in world markets and left the Federal Reserve vulnerable to a run on its gold reserves. Bretton Woods had imposed costs on the US greater than its benefits, so Washington had terminated the regime and replace it with a new, US-friendly, international monetary order. The end of Bretton Woods constituted a demonstration of US power and was not the product of US weakness.

Strange's contribution to this debate was arguably the most interesting. She introduced the conceptual difference between "relational power" (the power of one state over another) and "structural power" (the power to create international structures that shape other states' behaviours and expectations).⁹⁷ Many scholars, especially Marxists and Realists, accepted Strange's "structural power" innovation and her claim the US had used its structural power to replace Bretton Woods' fixed exchange rate system with a floating exchange rate system. These scholars, like Strange, tended to dismiss the importance Liberals attached to international institutions and regimes, seeing them as little more than fig leaves for obscuring a hegemon's power.⁹⁸ Strange's structural power explanation of Bretton Woods' collapse became widely accepted over time, including by Realists Kunz and Seabrooke, with the latter elaborating on Strange's concept and extending its application, and by Marxists Gowan, Panitch and Gindin.⁹⁹ It is now probably the dominant explanation in scholarly circles, overtaking the "hegemonic weakness" explanation initially favoured by many Liberals (Table 2.1).

Marxists offered another theoretical challenge to the Liberals' hegemonic weakness explanation. In an otherwise outstanding analysis of the US' role in developing the international financial system, Panitch and Gindin valiantly, but unconvincingly, attempt to theorise how class conflict drove the US to terminate the Bretton Woods regime and replace it with a reformed international monetary

⁹⁷ Discussed in detail in the section on power in Chapter 1.

⁹⁸ See Strange, "Dollar crisis", and "CAVE! Hic dragons". Kindleberger and Aliber, *Manias, panics and crashes*, 238, held the same opinion: "Regimes work well in quiet times, but something more decisive in the way of leadership is called for in a crisis..."

⁹⁹ See Kunz, *Butter and guns*, and Seabrooke, *US power in international finance*, for Realist uses of the structural power concept. Marxists Gowan, *Calculus of power*, 238, and Panitch and Gindin, *Making of global capitalism*, 13, were united in their praise of Strange's structural power concept and her analysis of the US' destruction of the Bretton Woods regime.

order.¹⁰⁰ Gowan constructed a more convincing (albeit still flawed) theory, explaining shifts in US international monetary policy during 1969-76 in terms of successive US administrations seeking to create structural advantages for US capitalists over their rivals in Europe and Japan. In Gowan's opinion, US foreign economic policy was driven not by class conflict, but by national interest, which he defined in terms of US capitalists' interests.¹⁰¹ Moreover, Gowan believed agency as well as structure mattered, as when Washington decided to replace the Bretton Woods regime with a new international structure he called the Dollar-Wall Street Regime, to help the US impose its national, capitalist interests on other states.¹⁰²

Gowan also theorised the US had adopted a strategy of hegemonic rule through crisis: achieving relative gains in US power by creating international economic crises that damaged allies more than itself. He argued Washington believed the US economy was more robust and adaptable than its allies' economies when faced with crisis-driven changes in the world economy. This implied the US could achieve relative gains in economic power and reinforce its hegemony by creating international economic crises.¹⁰³ Gowan claimed Washington believed the US economy would be the first to pull itself out of any international crisis, creating an economic lead for itself while other capitalist and developing states struggled to recover. He concluded a confident Washington

¹⁰⁰ Panitch and Gindin, *Making of global capitalism*, 135-42

¹⁰¹ Gowan, *Global gamble*, 20: "The (C20's) main idea was to establish a new, reformed system in which Special Drawing Rights would play a central role as the international monetary anchor or numeraire to which the dollar would be subordinated. But it is now clear the Nixon administration had no intention of going along with such a scheme or with respecting the consensus of the conference. It was using the whole exercise as a means of buying time while it imposed its own will on events outside the conference discussions." Gowan's last point is a reference to OPEC's oil price increases in 1973.

¹⁰² *Ibid.*, 31: "The whole point of the Nixon moves to destroy the Bretton Woods system and set up the Dollar-Wall Street Regime *was to put America first*." See also Gowan, *Calculus of Power*, in which he described his model of the state and its decision-making role in terms broadly matching that adopted in neoclassical realism. He also acknowledged his willingness to adopt "back casting" as an analytical technique, i.e. assuming an outcome was the product of a successful US policy, then imagining how and for what reason the US adopted the supposedly successful policy. His attribution of a policy of "hegemony by crisis" is an example of this somewhat dubious analytical technique.

¹⁰³ Gowan, *Global gamble*, 21: "It is still widely believed that the sharp and steep oil price increase in 1973 was carried out by the Gulf states as part of an anti-Israel and anti-US policy connected to the Yom Kippur war. Yet as we now know the oil price rises were the result of US influence on the oil states and they were arranged in part as an exercise in economic statecraft directed against America's 'allies' in Western Europe and Japan...the principal political objective behind Nixon's drive for the OPEC oil price rise was to deal a crippling blow to the Japanese and European economies, both overwhelmingly dependent on Middle East oil..."

would always be willing to gamble on plunging the global economy into crisis as a route to enhancing US hegemony over the West.

Gowan's view is the antithesis of Liberals' belief in the hegemon playing the role of stabiliser and exercising strategic self-restraint. His description of a US-led international monetary regime that reproduces itself through crisis appears absurd, especially when one recalls the US was a hegemon leading security alliances constructed to contain Soviet and communist expansion.¹⁰⁴ Crises from which the US made relative economic gains by recovering faster than its allies might, as Gowan argued, have strengthened the US' position within its Western alliances. But such crises would surely have weakened those alliances relative to their main rivals in the communist Warsaw Pact, reducing Western security by redistributing power from West to East. Gowan claimed Washington created the OPEC oil crisis.¹⁰⁵ He was wrong about that, but right to challenge structural Realist theories as to how floating exchange rates replaced fixed exchange rates. As outlined below, Gowan had a point: his theory accurately described a US tactic in the Year of Europe negotiations.¹⁰⁶

Conclusions

My analysis of theories of hegemony convinces me hegemony is neither dominance nor a combination of preponderant material capabilities and political will, as many theorists claim. Rather it is a social construct in which the state acting as hegemon does so with the willing consent of its followers. A state's hegemony is of uncertain duration because it depends on other states freely

¹⁰⁴ Ibid., 31: "There is a very strong international interest in international monetary stability. Yet instead the Dollar-Wall Street Regime has seen the price of the main international currencies driven up and down in wild swings without historical precedent, swings that make even the 1930s look like an era of monetary calm! This extraordinary volatility has been the product of deliberate US policy and of Washington's refusal to work towards a stable, rules-based system."

¹⁰⁵ Ibid., 21: "... the oil price rises were the result of US influence on the oil states and they were arranged in part as an act of economic statecraft directed against America's 'allies' in Western Europe and Japan."

¹⁰⁶ See chapter 6 below for a description of Kissinger's use of hegemony by crisis in his effort to advance US objectives in the Year of Europe negotiations. The crisis in this case was monetary: his attempt to derail European integration by persuading European states to adopt an apparently unmanageable combination of locking their intra-EEC exchange rates into an EEC fixed exchange rate system (the "snake in the tunnel" monetary union) while at the same time floating EEC currencies against the dollar.

giving their consent to follow their hegemon. This can be withdrawn quickly; it is not subject to historically-determined, lengthy, cyclical processes. A state wishing to perpetuate its hegemony must actively work to retain its followers' consent. It must provide them (and itself) with public goods - including a functioning international monetary system - and generate support and consent by providing follower states with legitimate opportunities for policy influence. And it must capitalise on its structural advantages to ensure it has the resources needed to sustain the concentration of material power that helps make it an attractive, sustainable choice as hegemon.

Legitimacy matters to the hegemon *and* its follower states. Legitimacy is a force mobiliser and multiplier, helping to reduce the hegemon's order-creation and maintenance costs. Legitimacy also acts as a constraint, however, limiting the hegemon's freedom of manoeuvre and reassuring follower states they will not be exploited. The legitimacy of decision-making processes may be as important to followers as the legitimacy of decisions derived from those processes. A hegemon's legitimacy may be jeopardised unless it does the right thing in the right way. This argument informs my analysis of US attitudes towards the international monetary order and its reform during 1969-76.

Scholars have long debated whether the Bretton Woods regime ended because the US could not or would not support it. Hegemonic weakness or strength? I will use my concepts of negative and positive structural power to analyse these competing explanations in the following chapters.

Gilpin's marginalist change model of a hegemonic cycle contains many useful insights, including the idea that there can be no predictable direction of change in a hegemon's power. This suggests policymakers always have a chance of success when seeking to enhance the hegemon's power: however long hegemony may have lasted, it is not doomed by the clock as some cyclical theorists claim. Gilpin is also correct when he argues a hegemon's foreign policy will be determined in part by domestic political factors: while international structures clearly play an important role in shaping a hegemon's foreign policy, agency does too. Neoclassical realism extends this idea, focusing attention on the foreign policy executive's role in mediating international structural imperatives through the prism of domestic politics. It is for this reason I choose neoclassical realism as the theoretical framework for this thesis. This creates a

need to understand the shifting composition of the US Foreign Economic Policy Executive which took the key international monetary policy decisions during 1969-76. My next chapter discusses its personnel and ideologies.

Chapter 3

The US Foreign Economic Policy Executive, 1969-76

“It would be goddamn easy to run this office if you didn’t have people to deal with.”

President Nixon¹

My case study begins by identifying and assessing the Foreign Economic Policy Executives in the Nixon and Ford administrations. As discussed in the previous chapter, neoclassical realist theory puts the “Foreign Policy Executive” at the heart of a state’s decision-making on foreign policy. By the same token, one may conceive of a Foreign Economic Policy Executive taking decisions on a state’s foreign economic policy.² Like its counterparts on the Foreign Policy Executive, its members must mediate between international imperatives and domestic politics as they construct and implement foreign economic policy.

¹ 19 May 1971 entry in Haldeman, Diaries, 289

² Neoclassical realists argue the state is a distinct structure within society. In their model of the state, an Executive Committee, comprising members of the political elite, is at its head. (Lobell, Ripsman and Taliaferro call the over-arching Executive Committee the “National Security Executive” to distinguish it from the specialised Foreign Policy Executive; other neoclassical realists are less prescriptive when naming the Executive at the top of a state’s hierarchy.) This Executive is responsible for all matters coming to the state’s attention.

The Executive Committee would be overloaded if it took day to day responsibility for all matters. To avoid this, one may imagine it creating specialised sub-committees to deal with specific issue areas, such as security, welfare, economics etc. Foreign policy is handled by the Foreign Policy Executive, which in turn delegates specific issue areas to smaller groups. International monetary affairs, for example, would be handled by the Foreign Economic Policy Executive, which would also be responsible for trade and other overseas economic issues. Co-ordination between the over-arching Executive Committee and its various sub-committees, and between the sub-committees themselves, is ensured by requiring at least some members of the Executive Committee - perhaps all members when the most important issues are at stake - to approve the government’s adoption of a sub-committees’ policy recommendations.

This basic model of the state is not limited to neoclassical realists. Strikingly similar Marxist state models are used by Gowan, who regards the state as “the committee that tries to work out the strategic problems of its own national capitalists” (Gowan, *Calculus of power*, 241), and by Panitch and Gindin, who write of the state being “autonomous” from society and the narrow interests of individual capitalists (Panitch and Gindin, *Making of global capitalism*, 3-5).

The purpose of this chapter is to develop an understanding of the Foreign Economic Policy Executive in order to comprehend how its members approached their policymaking tasks. (Chapters 4-8 below draw on this understanding to examine the international and domestic political pressures on Nixon's and Ford's Foreign Economic Policy Executives at key decision points, and policymakers' attempts to use the 1969-76 international monetary crisis to strengthen US hegemony.) I identify the Foreign Economic Policy Executive's members and interpret information about their backgrounds, working methods and ideologies to explain how they operated. I also outline the formal and informal bureaucratic structures through which the Executive's members worked. Some knowledge of this is important because the Foreign Economic Policy Executive is an analytical construct, not a bureaucratic structure, and policymakers must work through bureaucracies and within their constraints to be effective. Understanding who the Executive's policymakers were, what drove them and through what bureaucratic channels they operated breathes life into the Foreign Economic Policy Executive analytical concept. It also helps defines the context within which foreign economic policy was made and, crucial for answering my research question, for what purpose particular decisions were taken. This lays the foundations for comprehending international monetary developments during 1969-76.

Membership of the Foreign Economic Policy Executive is a matter of judgement. The Executive is an analytical construct that had no precise, formally-constituted bureaucratic equivalent in the Nixon and Ford administrations (although the Quadriad group came close at times); and it had no *ex officio* members (except the president).³ My criteria for inclusion are that

³ A state's formal committee structure may or may not coincide with the neoclassical realists' model of the state run by an Executive Committee and its sub-committees. Most states have a formal Cabinet (or similar), chaired by the head of government; this corresponds to the neoclassical realists' over-arching Executive Committee. Most also have formally-constituted specialised, issue-specific Cabinet sub-committees and Working Groups. These formally-constituted bodies are likely to match the state's bureaucratic structure, helping bureaucrats feed their views into the policymaking process and co-ordinating policy implementation. These *de jure* structures are important, but they do not constitute the entire policymaking process. Some specialised sub-committees of interest to neoclassical realists are likely to be organised informally by the policymakers themselves based on need. These informal bodies may, *de facto*, be very important parts of the policymaking process, or even the most important parts.

The Nixon administration made considerable use of informal committees when dealing with international monetary affairs. In part this reflected the need to involve the chairman of the Federal Reserve Bank, Arthur Burns, in international monetary policymaking notwithstanding the Federal Reserve's formal independence from the US Executive branch of government. The latter reflects the US Constitution's use of checks and balances to limit the respective powers of

its membership was restricted to high-ranking decision-makers engaged in foreign economic policy, *and that they were able to influence the president on foreign economic policy issues*. Simply holding a high-level office that engages with foreign economic policy is insufficient. An individual must exert some – indeed considerable – influence over the president on foreign economic policy issues to be considered a member of the Foreign Economic Policy Executive.⁴ The evidence of influence can be found in archived documents as well as the picture of events that can be pieced together from policymakers' diaries and memoirs, and scholars' commentaries.

This chapter provides evidence agency matters to US foreign economic policy. It identifies how changes in its personnel changed the Foreign Economic Policy Executive's ideology and its attitudes towards international co-operation, changes that had a marked policy impact. For example, personnel changes brought a pronounced ideological shift as regards the role of markets: initially there was strong ideological opposition to allowing markets to determine exchange rates and international capital flows; by 1975, however, there was ideological acceptance that, in the absence of practical alternatives, markets might be the best way to determine such things, at least for the US. One also sees the Foreign Economic Policy Executive's attitudes towards US hegemony shifting erratically: should it be based on co-operation and consent, or on domination? Both policies were tried. These were agential changes occurring even when international structural conditions remained essentially unchanged. Acts of agency help explain why Ford was able to achieve the international monetary reform agreement that had eluded his predecessor.

the Executive, Legislature and Supreme Court. This has advantages, but it also complicates the task of designing, managing and co-ordinating macroeconomic policy when one of its two main policy variables is in the hands of the Executive and the other the Legislature.

⁴ For this reason David Kennedy, Nixon's first Treasury Secretary is excluded from the Foreign Economic Policy Executive, whereas all subsequent Treasury Secretaries (John Connally, George Shultz and William Simon) are included: they exerted an influence that Kennedy lacked. Similarly, George Shultz joined the Foreign Economic Policy Executive when he became Director of the Office of Management and Budget and began to influence foreign economic policy, an influence his predecessor and successors never demonstrated and are therefore excluded. And Paul McCracken and Alan Greenspan, chairmen of the Council of Economic Advisers under Nixon and Ford, respectively, are included because of their influence over foreign economic policy, whereas Herbert Stein (McCracken's successor) is excluded because his influence was largely over domestic and fiscal economic issues. Kissinger is included because, although largely uninterested in economic matters and holding no bureaucratic brief on foreign economic policy until his appointment as Secretary of State, he intervened in foreign economic policy at key moments in his efforts to bring coherence and consistency to US foreign and foreign economic policies.

After discussing concepts in chapter 1, and defining hegemony and selecting my theoretical framework in chapter 2, this chapter provides the third and final building block I need to answer my research question in chapters 4-9. The chapter has five sections: sections on the Nixon administration's bureaucratic structures and brief biographies of the Foreign Economic Policy Executive's members (Nixon, Connally, Kissinger, Burns, McCracken, Shultz and Volcker) are followed by sections on the Ford administration's bureaucratic structures and biographies of its Foreign Economic Policy Executive members (Ford, Simon and Greenspan). It ends with a concluding section.⁵ The picture that emerges is of functional Foreign Economic Policy Executives, and a clear sense of policymakers' ideological and political attitudes, both towards international monetary affairs and towards strengthening US hegemony.

Nixon Administration: Structures

Congress sets the legal framework for US international monetary policy. If the President acts within the legal framework, prime responsibility for setting international monetary policy rests with him. If the President wished to amend the law or required new legislation, he must ask Congress to legislate. Day to day responsibility for international monetary affairs rests with the Treasury and the Federal Reserve. Briefed by officials, the Treasury Secretary advises the President on international monetary policy: Treasury officials are responsible for policy analysis, design and implementation. The Federal Reserve answers to Congress; it is independent of the Executive. It assists the Treasury by implementing international monetary policy. The Federal Reserve has no formal responsibility for making international monetary policy, but its experience of policy implementation and its relationship with foreign central banks ensures its advice is usually sought by the President, Treasury Secretary and Congress.

The Cabinet is intended to play a key strategic role in the US system of government; the Treasury Secretary is a member. One might have expected

⁵ Burns and Kissinger retained their membership of the Foreign Economic Policy Executive under Ford; their biographical details are not repeated.

President Nixon to have taken his most important decisions on international monetary affairs on his Cabinet's advice. In fact this never happened.

Nixon believed in centralising power based on a division of labour and expertise.⁶ He also believed non-specialists usually added no value to a discussion of specialists' recommendations.⁷ He tried to keep such issues away from the whole Cabinet, although he did create the Cabinet Committee on Economic Policy (CCEP) in response to Cabinet members demanding to be consulted on economic issues.⁸ Nixon chaired the CCEP for a year, but wearied of the task and ceased to attend regularly from 1970.⁹ Paul

⁶ Former Commerce Secretary Stans described how Nixon concentrated policymaking in the White House. His closest advisers, the "inner orbit", were Haldeman, Ehrlichman, Colson and Kissinger, each specialising in a separate policy area. Connally also joined the inner-orbit; Shultz worked his way into it over time. The next rank of officials, which Stans described as the "outer-inner orbit", comprised Flanigan, Klein, Gament, Ziegler, Cole and all members of the Cabinet except Connally and, eventually, Shultz. Stans believed the key distinction between those in each orbit was their degree of access to the president. Those in the "inner orbit" enjoyed instant access; those in the outer-inner orbit were kept at "arms' length from the president" (Stans, *One of the president's men*, 217).

⁷ "I felt that the matters brought before a President for decision should be only those that cannot or should not be made at a lower level on the White House staff or by the Cabinet member responsible for them. ...I had attended hundreds of Cabinet meetings as Vice President, and I felt most of them were unnecessary and boring. ... (T)he day had long since passed when it was useful to have the Secretary of Defence and the Secretary of State discuss the Secretary of Transportation's new highway proposal" (Nixon, *Memoirs*, 337-38). Haldeman provided an alternative explanation of the Cabinet's feebleness: "Nixon never intended the cabinet to be a board of directors. He never took a vote and would have cared less concerning the result; he didn't make any pretext of seeking consensus" (quoted by Summers and Swan, *Arrogance of power*, 329).

⁸ Haldeman, *Diaries*, 21, records the CCEP was created on 24 January 1969 after Commerce Secretary Maurice Stans complained to the President that he and Cabinet colleagues were being excluded from decisions on economic matters.

⁹ Nixon's lack of interest in collective discussion of policy issues created tensions within his administration (Matusow, *Nixon's economy*, 16). Nixon, an introvert by nature, found it difficult to consult or trust others. In one outburst he told Kissinger "Screw the Cabinet and the rest! ... I'm sick of the whole bunch. The others are a bunch of gaddamned cowards. The staff, except for Haldeman and Ehrlichman, screw them! The Cabinet, except for (Treasury Secretary) Connally, the hell with them" (Summers and Swan, *Arrogance of power*, 330). The excluded Cabinet eventually reacted. Ehrlichman, commenting on relations between Nixon and his Cabinet colleagues, noted "It got so bad that in about the third year we heard of a rump session of the Cabinet. They actually held a meeting over at (Housing and Urban Development Secretary) George Romney's conference room to discuss economic problems because they couldn't get any discussion at the Cabinet table... it was a mini-revolt... Nixon was terribly upset" (Summers and Swan, *Arrogance of power*, 329).

Nixon's lack of trust went beyond his Cabinet, extending to the whole Federal bureaucracy. On 29 June 1971 Nixon warned his Cabinet to distrust the civil servants in their Departments: "You're all on the top and you have a few loyal lieutenants, but beneath you you have a whole Department full of vipers and they'll strike because they want to beat us, especially next year (the year of the presidential election). For example Goldstein at the Bureau of Labour Statistics, a left-wing radical who hates us... don't worry about not being an open administration: civil servants aren't appointed to represent us" (Haldeman, *Diaries*, 310). Nixon's vendetta against Goldstein led to an infamous incident in which he ordered a White House aide, Frederick Malek, to demolish and dismiss the "Jewish cabal" at the Bureau of Labour Statistics

McCracken, chairman of the Council of Economic Advisers, was similarly unimpressed by the CCEP, regarding it as too large and unwieldy, lacking the economic expertise it needed to make an effective contribution to economic policymaking.¹⁰ Like the Cabinet, the CCEP made no discernable contribution to US international monetary policy.

The one formally-constituted body that made substantive contributions on international monetary affairs was a relatively junior body within the US bureaucracy, the Working Group on US International Monetary Policy.¹¹ Chaired by the Treasury Undersecretary for Monetary Affairs, Paul Volcker, it soon became known as the “Volcker Group”. It provided the members of the Foreign Economic Policy Executive with influential analysis and policy advice. It

to prevent its civil servants from using official unemployment statistics selectively to misrepresent and undermine his administration (Ambrose, *Triumph of a politician*, 457).

Goldstein was not an isolated example. Richard Helms, CIA Director, observed “Nixon never trusted anyone in the Executive Branch. Here he had become president of the United States and therefore the chief of the Executive Branch, and yet he was constantly telling people that the State Department was just a bunch of pin-striped, cocktail-drinking diplomats, that the Agency couldn’t come up with a winning action in Vietnam, and that the Interior Department was full of ‘pinkos’. It just went on and on” (Summers and Swan, *Arrogance of power*, 330). This inability to trust those serving the state affected Nixon’s decision-making style, resulting in him making key decisions on the basis of limited consultations and imposing the resulting policies on an unprepared civil service and Congress, as well as foreign states.

¹⁰ Reichley, *Conservatives*, 207. The CCEP had a regular membership of 12, rising to 13 when the Federal Reserve chairman was invited to participate. The core membership comprised the President, the Vice-President, Secretaries of the Treasury, Agriculture, Commerce, Labour and Housing and Urban Development, two Counsellors to the President, the director of the Bureau of the Budget, the Deputy Undersecretary of State for Economic Affairs and the Chairman of the Council of Economic Advisers.

¹¹ The Working Group was created by National Security Memorandum No 7, a secret document issued on 21 January 1969, only a day after Nixon’s inauguration as president (Duncombe, *Foreign economic policy*, 290-91). Kissinger’s Memorandum informed Volcker the President required him to chair a permanent Working Group “... to make recommendations on US International Monetary Policy to the National Security Council and to implement its policy decisions.” Volcker was told to get the ball rolling early. He was instructed to produce the Group’s first study on “the functioning of the international monetary system” and prepare “contingency plans for responses to potential currency crises...” for delivery to the National Security Council by 15 February 1969. Volcker was to be assisted in his efforts by the Undersecretary of State for Economic Affairs, the chairman of the Council of Economic Advisers, a member of the NSC staff and a member of the Board of Governors of the Federal Reserve System. Representatives of “the agencies” were to participate as necessary.

The Volcker Working Group’s locus within the US bureaucracy was controversial initially. In an early indication of Kissinger’s intention to keep his finger in every pie relevant to foreign policy, his Memorandum to Volcker required the Working Group to report to the National Security Council (NSC), not the Treasury as might have been expected on such an issue. Volcker initially objected to Kissinger and his NSC asserting authority over the Treasury. He complained to Treasury Secretary Kennedy about this, who in turn attempted to enlist the assistance of Burns, then marking time as Counsellor to the President on the White House staff until the chairmanship of the Federal Reserve became vacant (Burns and Ferrell, *Secret diary*, 4-5). Burns told Kennedy to “stand firm” and arranged a meeting with Kissinger to resolve the matter. Apparently Kissinger also stood firm because Volcker ended up resolving the matter by inserting a sentence in Kissinger’s Memorandum to the effect that the Treasury Secretary would inform the NSC of issues important to defence and foreign policy (Silber, Volcker, 56).

designed the international monetary reform plan the US proposed to the Committee of 20 (C20) in 1972. The Working Group also played an important co-ordinating role within the US bureaucracy.¹² Its prominent role reflected the fact it was the only formally constituted inter-departmental body available to Shultz and Volcker in the international monetary sphere.¹³

The Volcker Group produced international monetary policy analysis and recommendations, but it could not take decisions. These were taken in informal groups: the “troika” and Quadriad; both met regularly.

The Nixon administration’s troika began surprisingly informally. It brought together the Treasury Secretary, the director of the Bureau of the Budget and the chairman of the Council of Economic Advisers (CEA).¹⁴ They met weekly for breakfast at Washington’s Cosmos Club, ostensibly to agree economic forecasts.¹⁵ In fact their discussions ranged more widely over economic affairs and the group was empowered to take policy decisions that did not require presidential approval.¹⁶ John Connally moved the troika meetings into the Treasury when he replaced David Kennedy as Treasury Secretary in December 1970.

¹² The Working Group played a key co-ordinating role in summer 1972, for example, when Treasury Secretary Shultz used it to build cross-departmental bureaucratic support within the administration for the international monetary reform plan the US tabled at the C20.

¹³ Strictly speaking there were two other officially constituted economic bodies: the Council on International Economic Policy (CIEP); and a Shultz-chaired Cabinet-level economic policy committee that effectively replaced the CCEP in 1973.

Nixon established the Council on International Economic Policy in January 1971 under Peter Peterson’s direction. He was a successful businessman brought into the administration to strengthen Nixon’s economic team. CIEP was chaired by the President; it had high-level membership, including the Secretaries of Agriculture, Commerce, Defence, State and Treasury, the Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisers and the President’s Adviser for National Security Affairs. It tended to focus on trade issues, where it began to have some policy impact. Peterson subsequently attempted to involve it in international monetary affairs. This precipitated an immediate row with Treasury Secretary Connally, furious at Peterson trespassing on what Connally considered his domain. Nixon instantly moved Peterson to become Secretary for Commerce, replacing him with Peter Flanigan as the new CIEP Executive Director. The Committee’s influence evaporated.

Nixon reorganised the Federal government’s structures and consolidated the entirety of economic policy under Shultz, his “economy czar” at the start of his second term as president. He appointed Shultz as his new Assistant to the President with responsibility for economic affairs. As well as retaining his role as Treasury Secretary, Shultz was required to exercise oversight of the Departments of Agriculture, Commerce, Labour and Transport. He created a new Cabinet-level committee to facilitate this economic work, rendering the CCEP redundant.

¹⁴ Following a reorganisation of the Federal bureaucracy, this became known as the Office of Management and Budget.

¹⁵ Matusow, *Nixon’s economy*, 9

¹⁶ Reichley, *Conservatives*, 207

The Federal Reserve Board chairman joined the troika once a month in a meeting known as the Quadriad. Nixon usually chaired these meetings, normally in the White House.¹⁷ Participants' seniority made it the most powerful informal group dealing with international monetary policy.

There was another informal group in addition to the troika and Quadriad. It met only once, at Camp David on 13-15 August 1971. But what a meeting! It agreed, *inter alia*, to impose a temporary national wages and prices freeze and to suspend gold convertibility, effectively ending the Bretton Woods regime. Sensing the historic nature of their discussions, Nixon marked the event for the 15 participants by giving each a specially-designed commemorative jacket; he recorded the event for history by ensuring all present signed the guest book and were included in a formal group photograph.¹⁸

Nixon's Camp David group demonstrated informal bodies could be more influential than those formally constituted within a bureaucracy. Nixon convened the secret Camp David meeting supposedly to take crucial economic decisions that would have a major impact on the US' domestic and external economic policies. In fact the President had already decided it was time to take dramatic actions and he knew in broad terms what he wanted to do to boost the US economy. His real purpose in convening the meeting was not to seek detailed policy advice from those present, but to implicate his economic team in the decisions he was about to take. He wanted his squabbling economic advisers to come out of the meeting having "dipped their hands in blood", creating a sense of collective responsibility for the politically painful decisions he was about to take. In particular, he needed to commit the independently-minded and verbose Arthur Burns to his administration's "New Economic Policy". Had Burns not been personally involved in the Camp David decisions, he could have used the Federal Reserve chairman's constitutional right to speak independently and critically, undermining public confidence in Nixon's

¹⁷ Small, *Presidency of Richard Nixon*, 204

¹⁸ Reproduced in Volcker and Gyohten, *Changing fortunes*, after p172. The photograph shows President Nixon with John Connally, Treasury Secretary, Paul Volcker, Treasury Undersecretary for monetary affairs, Michael Bradfield, assistant legal counsel US Treasury, Arthur Burns, chairman of the Federal Reserve Board, George Shultz, director of the Office of Management and Budget (OMB), Casper Weinberger, deputy director OMB, Kenneth Dam, assistant director of OMB, Arnold Weber, associate director OMB, Paul McCracken, chairman of the Council of Economic Advisers (CEA), Herbert Stein (CEA), Peter Peterson, assistant to the President, William Safire, presidential speechwriter, Robert Haldeman, White House chief of staff, and John Ehrlichman, assistant to the President for domestic affairs.

controversial New Economic Policy. Nixon needed collective responsibility to shield himself against Congressional, media and international criticism. Creating an informal group was his way of building that shield.

Despite the importance of the decisions to be taken, the group of 15 that met at Camp David did not constitute the Nixon administration's Foreign Economic Policy Executive. Some officials present, such as the Treasury's legal counsel, were relatively junior and attended for issue-specific reasons. Others, such as the speechwriter, Safire, were there for straightforward functional purposes and otherwise were rarely involved in monetary or economic issues. And one influential member of the Foreign Economic Policy Executive was preparing himself for a secret diplomatic meeting in Paris and therefore absent from Camp David. So who were members of Nixon Foreign Economic Policy Executive?

Nixon Administration: Foreign Economic Policy Executive Personnel

My analysis suggests there were no more than seven core participants in Nixon's Foreign Economic Policy Executive at any one time during 1969-74:

- President Nixon
- Treasury Secretary (Connally/Shultz/Simon)
- Budget Director (Shultz)
- CEA Chairman (McCracken)
- Chairman, Federal Reserve Board (Martin/Burns)
- Treasury Undersecretary for Monetary Affairs (Volcker)
- National Security Adviser (Kissinger).

Who were they? What were their ideologies and views on international monetary affairs that would inform their decisions on foreign economic policy?

Richard Nixon

Only the president could decide on US international monetary policy; other members of the Foreign Economic Policy Executive advised and/or implemented policy. Nixon faced minimal domestic political pressures concerning international monetary policy most of the time and, as noted above, he often side-lined his Cabinet. Comparatively little legislation was involved when setting international monetary policy: interest groups lobbying via Congress or government Departments were ineffective, in part because the opposing exchange rate interests of export and import lobby groups tended to balance out.¹⁹ So the President had an unusually free hand on international monetary policy. Yet the topic, in common with all technical aspects of the Dismal Science, bored Nixon.²⁰ He actively discouraged his advisers from bringing international monetary affairs to his attention.²¹ When, nonetheless,

¹⁹ Dam argued the US Treasury maintained a policy monopoly over exchange rate issues and considered “the financial community” to be its domestic constituency. He noted “when the Bretton Woods system was coming to an end and no one knew what would replace it...prominent commercial bankers did play a role, particularly in lobbying the Treasury.” Similarly, interest groups would lobby the Treasury on the dollar’s exchange rate. Dam observed, however, “having an interest is not the same as having an influence” (Dam, *Rules of the global game*, 196-97).

²⁰ Evans and Novak quote three members of President Nixon’s initial economic team: “‘This is not his long suit.’ ‘This is not his cup of tea.’ ‘This is not his background’ ” (Evans and Novak, *Nixon in the White House*, 181). Herbert Stein, appointed to the Council of Economic Advisers (CEA) when Nixon took office and the CEA’s chairman in January 1972, assessed Nixon did not understand economics and, rather than saying Nixon believed in the free enterprise system, it was more accurate to say he “was sceptical and cynical about government intervention in the economy... (Moreover) Nixon was no fan of big business... He thought of them as hypocritical, wrapping themselves in the mantle of free markets and the national interest while being as eager as everyone else to use the power of government for their own profit.” Stein observed Nixon did not especially care about the level of government spending as a share of GDP, rather he objected to government inefficiency and waste: “his favourite example being the hoard of State Department cookie-pushers he had encountered at his stops at US embassies around the world” (Stein, *Presidential economics*, 136-37). On 14 July 1994 Peter Flanigan, Assistant to the President for International Economic Affairs, commented in a letter to William Simon, Nixon’s Treasury Secretary during April-August 1974: “The President was, philosophically, a free marketeer. He just didn’t think it was important compared to the political advantages he could get from things like wage and price controls... and slamming the gold window” (Simon and Caher, *Time for reflection*, 100). Paul Volcker, Treasury Undersecretary for Monetary Affairs, saw Nixon had taken office without strong views on the international monetary system, only a feeling that something was wrong. In one of his earliest decisions as President Nixon authorised Volcker to lead a Working Group with a view to assessing the situation and making policy recommendations (Volcker and Gyohten, *Changing fortunes*, 66).

²¹ While being vague about nominating who should deal with international monetary affairs, Nixon made his feeling plain about his wish not to be personally involved in the matter in a 1970 memorandum to his officials “I do not want to be bothered by international monetary matters... and I do not want to see the reports on international monetary matters in the future. Problems should be farmed out. I want to have Arthur Burns if he is willing to assume it on a

his Chief of Staff, Haldeman, attempted to brief Nixon on a European currency crisis that could affect the dollar, the President famously dismissed him, snarling “I don’t give a shit about the lira!”²² From time to time Nixon consulted Milton Friedman, the leading monetarist and free market economist in the US, but did not feel bound to heed his advice.²³

Nixon had built his political career as a conservative on social and economic issues, and an anti-communist in domestic and foreign policy.²⁴ Elected to the House of Representatives as a Republican in 1947, Nixon made his name nationally when he doggedly and successfully pursued the respected former diplomat Alger Hiss, proving – contrary to widespread expectations – Hiss had spied for the USSR.²⁵ Foreign policy was Nixon’s main interest. Selected by Eisenhower as his Vice President in 1953, Nixon travelled abroad on representational duties as much he could during his time in office (1953-61). This enabled him to polish his credentials as a foreign policy expert and simultaneously display his trademark anti-communism. Having been beaten narrowly in the 1960 presidential election, Nixon won in 1968. His campaign focussed on ending US involvement the Vietnam War and mending the US’ fraying social fabric by tackling crime, antagonistic racial relations and the

confidential basis, and if not Burns to Houthakker (an economist on the Council of Economic Advisers) who is very capable in this field. I have no confidence in the Treasury people since they will be acting in a routine way... I feel we need a new international monetary system and I have so indicated in several meetings. Very little progress has been made in this direction because of the opposition of the Treasury. I shall expect someone in the White House who will be designated who will keep the pressure on this area. The man, however, who could really be the lead man is Arthur Burns because he feels exactly as I do and it might be he could exert some influence on the others...” Memorandum from the President to Assistant to the President, Haldeman, Assistant to the President for Domestic Affairs, Ehrlichman and Assistant to the President for National Security Affairs, Kissinger; 2 March 1970 (Duncombe, Foreign Economic Policy, 94-95)

²² Quoted in Silber, Volcker, 110. The White House tapes released on 5 August 1974 – the so-called “smoking gun” tapes that sealed Nixon’s presidential doom – may explain Nixon’s impatience with Haldeman on 23 June 1972. The attempted briefing took place shortly after Nixon and his senior aides had discussed how they might obstruct investigation of the Watergate break-in (Black, A life in full, 825). Nixon evidently had more important matters on his mind that day than European currency fluctuations!

²³ Nixon regarded Friedman as “a dedicated Republican” and consulted him during the 1968 presidential election campaign. Nixon occasionally invited Friedman to the White House for private consultations (Matusow, Nixon’s economy, 13-14).

²⁴ Prior to being elected as President, Nixon generally favoured free enterprise, free markets, free trade (where reciprocated), prudence in fiscal and taxation policies and a monetary policy aimed at delivering low inflation. Combined with, and subordinate to, a large dose of political pragmatism, this was a fairly orthodox, moderate position on economics for a Republican politician. Genovese elaborates on Nixon’s economic views (Genovese, Nixon presidency, 65-67).

²⁵ See Mickelthwait and Wooldridge, Right Nation, 44, for a summary of this turning point in Nixon’s career, and Nixon, Memoirs, 52-71, for his own, more complete, account.

“excesses of the Permissive Society”. Although he claimed reducing inflation would be one of his top three policy priorities, the only specific Bretton Woods regime-related pledge Nixon made during the 1968 election campaign was to abolish the controls on capital outflows President Johnson introduced to help defend the dollar.²⁶ His pledge was not driven by economic concerns, but by his wish to differentiate his position politically from his Democratic opponent’s.

Philosophically, Nixon was a Realist. He believed national security was of overriding importance and could be achieved by the US amassing preponderant military and economic power.²⁷ The latter, Nixon asserted, should always be subservient to US political and military interests.²⁸ Nixon believed the US should be a global leader, but he was also a declinist, having concluded the US’ relative power had passed its high water mark by 1968.²⁹ He set out his views in a briefing he gave to news media executives in Kansas City in 1971,

²⁶ Nixon briefed Republican Congressional leaders on his priorities for his first term as President on 25 March 1969: “first, settle the war; second, establish law and order; third, stop inflation and settle the economy”; he proposed to concentrate his Presidential time on these three issues and leave the rest – “all the little side issues” – for to others to handle (Haldeman, Diaries, 43).

²⁷ On his visit to Beijing in 1972, Nixon told Prime Minister Chou En-lai “Each of us had to put the survival of his nation first, and, if the US were to reduce its military strength, and if the US were to withdraw from the areas I have described in the world (i.e. Europe and Japan), the dangers to the US would be great - and the dangers to China would be greater” (quoted in Reeves, *Alone in the White House*, 445). Nixon told Midwestern news media executives on 6 July 1971 “the security of America must come first... we are not going to be able to play an effective role in the world unless we have a healthy environment, economically and in every way” (see “The American Presidency Project” at <http://www.presidency.ucsb.edu/ws/index.php?pid=3069&st=Media+Executives8st1=Kansas+City>).

The mark of a realist’s approach to foreign policy is of course his attitude to power. Nixon was prepared to seek a balance of power with the USSR to neutralise the latter’s threat to US interests, and to use US power proactively to deliver his foreign policy objectives. Treasury Secretary Connally, also a realist, felt Nixon’s “strong point (was) that he understood the use of power” and used it “perceptively” (Haldeman, Diaries, 252). Nixon believed in the primacy of military power over other forms, and used it proactively, in Vietnam, Laos and Cambodia.

²⁸ Nixon made his priorities clear early, telling his CCEP colleagues on 13 February 1969: “Yes we can make every argument in the world economically, but you have to consider the political timing. Whenever political considerations are not present, we can afford to look at things from a purely economic standpoint. But that will not be often” (quoted in Matusow, *Nixon’s economy*, 16). There was to be no doubt that “high” politics would always dominate “low” in a Nixon administration.

²⁹ Haldeman recorded a conversation Nixon held with Kissinger, Ehrlichman and Haldeman on 21 July 1969 in which the President told them “(The) power of the United States must be used more effectively, at home and abroad, or we go down as a great power. (We) have already lost the leadership position we held at the end of WWII, but can regain it if (the White House) moves fast!” (Haldeman, Diaries, 73). Nixon feared the US was running out of time as the world’s leading power. On the flight to De Gaulle’s funeral on 11 November 1970 he told Ehrlichman “America has only two more years as the number one power ... (we will) make the best deals we can between now and 1975 or increase our conventional strength” (quoted in Matusow, *Nixon’s economy*, 84). Nixon returned to this theme repeatedly during his Presidency, which Joffe describes as “Declinism-Lite”, i.e. “not the end, but the shrinkage of America in terms of global power and prestige” (Joffe, *Myth of America’s decline*, 11).

telling them the period of bipolarity and US leadership of the West was about to be replaced by a world in which there would be three military power “poles” - the US, USSR and China - and three economic power “poles” - the US, Europe and Japan - and the US had to prepare itself for both co-operation and rivalry with the other powers.³⁰ This analysis set the scene for Nixon’s subsequent foreign policy, which aimed to achieve peace, security and prosperity for the US through a combination of détente, linkage and competition.

Until 1971 it had been enough for a US politician to be anti-communist and preach an undifferentiated policy to contain the communist world. Nixon changed that forever. The USSR’s rising nuclear power and China’s prospective rise convinced Nixon the US could no longer assume it could win a nuclear war.³¹ Henceforth, he argued, US politicians had to distinguish between different types of communism and be prepared to co-operate with communist states where détente agreements could be reached, as with the USSR in 1972.³² A policy of linkage would ensure the extent of US co-operation would be proportionate to the co-operation the US received from other states. Détente notwithstanding, communist states should still be seen as the US’ rivals. Competition would continue. Nixon’s “opening to China” in 1972 was widely, and correctly, interpreted as his attempt to bring China into diplomatic play on the US side to help balance against the USSR’s rising power. However, as well as being a co-operative move towards Beijing on Nixon’s part, it was

³⁰ In his remarks Nixon contrasted the geopolitical situation that had existed when he was elected to Congress, when the US was “number one in the world militarily ... and producing more than 50 per cent of all the world’s goods”, with the situation in 1971 and the coming decade, when the US would be competing with Japan and Western Europe for world economic leadership and with the USSR, “a very potent, powerful and aggressive competitor” as well as a China liberated from its current diplomatic isolation. See Nixon’s “Remarks to Midwestern News Media Executives Attending a Briefing on Domestic Policy Issues in Kansas City, Missouri” on 6 July 1971 at

<http://www.presidency.ucsb.edu/ws/index.php?pid=3069&st=Media+Executives&st1=Kansas+City>. Nixon repeated his analysis in an interview given to the editors of *Time* in 1971 (quoted in Kissinger, *World order*, 303-05). His intention in that interview was to signal to Chinese leaders the US wanted to end China’s isolation so it could take up a role as one of the five Great Powers in the multipolar system Nixon predicted would emerge in the next decade.

³¹ Nixon discussed China’s prospects and their implications for US foreign policy in terms that foreshadowed his opening to China in 1972: “Taking the long view, we simply cannot afford to leave China forever outside the family of nations... There is no place on this small planet for one billion people to live in angry isolation... The world cannot be safe until China changes. Thus our aim, to the extent we can influence events, should be to induce change” (Nixon, *Asia after Vietnam*, 121).

³² Following a successful visit to Romania in 1967, Nixon was especially keen on Ceausescu’s Moscow-unfriendly version of communism.

also a competitive tactic: it was his means of dividing the communist world, enabling the US to “play divide and rule” within it.

As for the economic poles, Nixon saw Europe and Japan as potential security collaborators and, simultaneously, rivals for economic power. There was no need for détente with them: Washington was co-operating with them through long-standing military alliances and joint participation in economic regimes, including Bretton Woods. Nixon was aware, however, the US’ position as world leader “can only be maintained if the United States retains its pre-eminent position in the economic field.”³³ He believed pursuing a policy of linkage, if it delivered relative economic gains for the US at its Western allies’ expense, could help the US secure its economic pre-eminence, which he expected to be the key to perpetuating US leadership. To their consternation, the US’ allies found Nixon was as ruthless when using linkage and “divide and rule” tactics against them as he was against the communist world.

Nixon sought relative economic gains for the US by extracting new trade, exchange rate and defence burden-sharing concessions from Europe and Japan in the second half of 1971, effectively demanding a higher price for the security the US provided to allies.³⁴ Nixon pursued linkage again in 1973 in an effort to ensure EEC states conceded what he and Kissinger wanted in the “Year of Europe” negotiations. This time he attempted to disrupt European integration and block agreement on international monetary reform in the C20 negotiations until the US had got what it wanted from Europe.³⁵

Nixon’s insistence on linkage alarmed the US’ Western allies. It raised the possibility of the US adopting a policy of hegemony through domination instead of its post-war approach of consensual hegemony.³⁶ Nixon’s love of springing policy surprises raised further doubts about US hegemony. Delivering leadership through a series of policy surprises from the White House left no opportunity for the US and its followers to negotiate on objectives, develop

³³ Nixon “Remarks to Midwestern Media Executives” on 6 July 1971 at: <http://www.presidency.ucsb.edu/ws/index.php?pid=3069&st=Media+Execitives8st1=Kansas+City>

³⁴ Discussed in chapter 4

³⁵ Discussed in chapters 6 and 7

³⁶ See the discussion of hegemony in chapter 2 above.

policy jointly and agree action consensually.³⁷ Nixon's "like it or lump it" approach to diplomacy suggested leadership through domination, not consensual hegemony. It provoked mulish responses from Japan and French-led opposition from Europe. This limited Nixon's gains from his linkage policies, notably in the international monetary sphere, because the US did not possess the positive structural power Nixon needed to dominate and achieve linkage: Europe and Japan possessed enough negative structural power to block him.

Nixon understood the importance of economic power to the US and its contribution to military power.³⁸ But, while the technical aspects of economic policy did not interest him, the political consequences of economic policy were of consuming interest, especially when it came to using fiscal and monetary policy to manipulate the business cycle to his political advantage. He associated low levels of unemployment with favourable electoral prospects and urged - bullied even - his economic advisers to creating economic booms to coincide with election campaigns.³⁹ Nixon wanted the US electorate to

³⁷ Allies were given no prior notice when Nixon announced he intended to visit China or close the gold window, both of which occurred within the space of one month in 1971. What US citizens recall as Nixon's "opening to China" is recalled in Japan as the "Nixon Shokku" (see Volcker and Gyohten, *Changing fortunes*). Maurice Stans, who had known Nixon for most of his career, observed from his position of Commerce Secretary, Nixon's manifestations of "erratic behaviour under pressure" reflected inner tensions created by Nixon being "an introvert who had chosen the life of an extrovert" (Stans, *One of the president's men*, 268).

³⁸ Nixon recognised the need for economic power, albeit in a supporting role. Speaking to the first meeting of the National Productivity Commission, 29 June 1971, he said "It's terribly important we be number one economically because otherwise we can't be number one diplomatically or militarily" (quoted in Reeves, *Alone in the White House*, 343). Nixon was especially concerned by the decline in US relative economic power after 1945. He sought to limit the economic burdens on the US of sustaining the international order. Détente and arms control negotiations with the USSR were intended in to limit the economic burden of competing with the USSR as well as reducing conflict risks. He avoided President Kennedy's expansive "pay any price" approach to containing the USSR by announcing the "Nixon doctrine", by which the US would help states that helped defend themselves against communist expansion. He defended his decision to close the gold window in 1971 on straightforwardly Realist grounds, seeing the measure as a means of sustaining US power. Asked in a press conference on 16 September 1971 whether closing the gold window had left the US' friends more shaken than its enemies, Nixon told reporters "...a weak America will inevitably be isolationist. An America that is unable to maintain its military strength - and incidentally in the whole free world the United States pays two thirds of the military bill today - a weak America that is unable to have its economic programmes abroad, our economic (aid), our foreign aid, the rest, will inevitably withdraw into itself. We have to have a strong America, strong economically and strong in the sense of its competitive spirit if the United States is to continue to play a vigorous, activist role in the world." (quoted in Johnson, *Nixon Presidential press conferences*, 208).

³⁹ Abrams, "How President Nixon pressured Arthur Burns", and Pierce, "Political Economy of Arthur Burns", provide detailed descriptions of the sometimes heavy and unscrupulous pressure Nixon and his White House staff applied to Burns in pursuit of obtaining an aggressively expansionary monetary policy from the Federal Reserve. Nixon put strong and prolonged pressure on Burns, telling him repeatedly to "Err towards inflation" in the effort to ensure a growing economy and falling unemployment in 1972, a message he repeated on 15 December 1970 (quoted in Reeves, *Alone in the White House*, 286). When Burns appeared

experience the “feel good factor” of full employment and rising living standards at voting time.⁴⁰ He told his economic team not to worry about the inflationary consequences of creating a boom: employment was what affected election results, not inflation.⁴¹ While Volcker and his “viper” Treasury civil servants understood the Bretton Woods regime gave the US certain policy advantages, they also knew the regime’s survival depended on the US respecting its responsibilities for delivering “sound money” and low inflation.⁴² The increasingly precarious balance of US international economic rights and

resistant or independent of the White House, Nixon blocked Burns’ preferred appointments to the Federal Reserve’s board, threatened to end the Federal Reserve’s statutory independence, and even mounted a smear campaign against Burns through White House aide Charles Colson, reputedly the most devious of Nixon’s White House aides. By 1971 Nixon was using three subordinates - Haldeman, Ehrlichman and Colson - for three different approaches to some projects.” Haldeman - “straightforward and brutal”; Ehrlichman - for “intrigue”; “and Colson was assigned the real underground routs” (Haldeman and DiMona, *Ends of power*, 111). Burns recorded much of this in his diaries and, after buckling under White House pressure, wrote plaintively on 5 November 1971 “The President’s preoccupation with the (1972 presidential) election frightens me. Is there anything that he would not do to further his re-election? I am losing faith in him and my heart is sick and sad” (Burns and Ferrell, *Secret diaries*, 63).

⁴⁰ When the CCEP discussed tightening macroeconomic policies, Nixon warned “I remember 1958. We cooled off the economy and cooled off 15 senators and 60 congressmen at the same time” (quoted in Gowa, *Closing the gold window*, 68). Nixon blamed his 1960 presidential election defeat largely on Federal Reserve chairman William McChesney Martin tightening monetary policy to curb employment and living standards.

Nixon was a good judge of how to tailor macroeconomic policy to create a boom in time for an election. When the economy moved into recession at the end of 1969, Nixon reminded his Cabinet of his political priorities in a meeting in January 1970: “Inflation never defeated an Administration - but recession has. ... If the Administration comes into the (mid-term) election with a recession and fear-of-recession psychology abroad in the country, then candidates in the marginal districts will fall... If our candidates are defeated and we can’t hold our own in the House and Senate, we will not have enough responsible members to carry on the fight against inflation... So what we must do is avoid fear of a recession” (quoted by Reeves, *Alone in the White House*, 166). Nixon reacted bitterly to the Republicans’ electoral failures in 1970, blaming the outcome on the economy and his economic team’s poor advice and performance. He told Haldeman on 5 November “Without economic drag (we) would have carried both House and Senate” (quoted by Matusow, *Nixon’s economy*, 83). Shortly before the 1970 mid-term elections, Nixon told Ehrlichman the administration’s economic policies were now aimed specifically at manipulating the electoral climate for the benefit of these elections: “I really want the economy to boom beginning July ‘72” (Reeves, *Alone in the White House*, 264). When discussing budget proposals with his Cabinet in June 1971, Nixon instructed them “we are now thinking of spending in political terms”, emphasising the need to cut opposition-friendly spending and create jobs with new programmes; he assessed it was already too late for tax measures to affect domestic spending ahead of the presidential election in 1972 (Haldeman, *Diaries*, 297). And, in conversation with Federal Reserve chairman Burns on 14 February 1972 in which he was urging Burns to deliver an ever-more expansionary monetary policy, the White House tapes revealed Nixon had a good grasp of the importance of monetary policy’s lags: “I don’t much, I don’t really care what you do in April, but between now and April (garbled)... that can hurt us in November” (quoted in Abrams, “How President Nixon pressured Arthur Burns”, 184).

⁴¹ For example, on 4 November 1971 Nixon told Federal Reserve chairman Burns “I cannot think of one election where inflation had any effect whatever in determining the result” (Small, *Presidency of Richard Nixon*, 211).

⁴² See Volcker and Gyohten, *Changing fortunes*, 63, for Volcker’s views on “the burdens of leadership”.

responsibilities appeared never to enter Nixon's political calculations: he prioritised his re-election, not the US' international economic obligations.

John Connally

Connally became Treasury Secretary because others either could not or would not do the job. When the mid-term elections were held in November 1970 the US economy was in poor shape despite Nixon's instructions to his economic team to curb inflation without causing a recession or raising unemployment. The Republican Party failed to make the Congressional gains Nixon targeted.⁴³ Nixon blamed Treasury Secretary Kennedy and sacked him on 7 November 1970.⁴⁴ Nixon failed to persuade Arthur Burns to resign from his new position as chairman of the Federal Reserve to take over at the Treasury.⁴⁵ He then remembered John Connally.⁴⁶ Nixon made Connally an audacious offer: Nixon said he wanted Connally "desperately" as Treasury Secretary now and in another "more important position" later (i.e. the vice presidency).⁴⁷ Nixon told Connally he felt he was "the only man in the Democratic Party who could be President and that we have to have someone in the Cabinet who is capable of being President... there wasn't a man in the whole shop (Nixon) respected this way".⁴⁸ Connally accepted.⁴⁹

⁴³ The Republicans gained two seats in the Senate, not enough for a majority, and lost nine in the House of Representatives, leaving them in a minority there as well.

⁴⁴ After much dithering, Nixon despatched Kennedy as US ambassador to NATO.

⁴⁵ Burns' diary entry for 23 November 1970 records he declined the President's offer (Burns and Ferrell, Secret diaries, 28-30)

⁴⁶ Nixon established the President's Advisory Council on Executive Reorganisation under Roy Ash's leadership to help him streamline the Federal bureaucracy. Connally's work for the Council impressed Nixon. Haldeman remarked at the time "Connally tracks well with the P(resident) and would be an excellent addition if we could get him" (Haldeman, Diaries, 135).

⁴⁷ Nixon never definitively dropped this idea until Watergate had discredited his presidency and Vice President Agnew had been obliged to resign to face unrelated criminal charges. On 7 April 1971 Nixon revealed to Haldeman his plan to engineer Vice President Agnew's resignation in order to promote Connally into the job, thereby avoiding the need for a selection process within the Republican Party that Nixon believed Ronald Reagan would win (Haldeman, Diaries, 269). On 19 July 1971 Nixon told Connally he wanted him as his Vice President or, failing that, his Secretary of State (Ibid., 323). Nixon only dropped this plan when he was persuaded the Republican leadership would not accept his appointing a Democrat as Vice President; Connally did not resign from the Democratic Party until after he had left the Nixon administration. Yet the idea persisted in Nixon's mind. On 12 June 1972 Connally declined Nixon's suggestion he run as Nixon's Vice President in the 1972 campaign, saying he would prefer to be appointed Secretary of State (Ibid., 470).

⁴⁸ Ibid., 215

Nixon pulled off a coup by recruiting a senior Democrat to fill a crucial position in his administration.⁵⁰ Nixon admired Connally for his political and presentational skills, and wanted Connally to help him deal with his otherwise dreary Cabinet as his “counsellor, adviser and friend”.⁵¹ Above all Nixon wanted the company of another leader who would prioritise political interests and would have the ability to persuade Congress to support Nixon’s new economic programmes. He admired Connally’s dominating approach, admitting: “everything that Connally touches in the political area, Connally controls”.⁵² By January 1972, Nixon had come to regard Connally’s presence in his administration as “indispensable”.⁵³ Safire observed “Connally meant stimulation, excitement and political savvy to Nixon... the boss is in love!”⁵⁴

Nixon welcomed Connally’s “big play” and combative mentality. Connally gave Nixon the confidence to take far-reaching decisions on economic matters, an area in which Nixon had hitherto been uncertain, hesitant and disengaged. Had Nixon Connally not trusted Connally absolutely, it is hard to believe he would have taken August 1971’s bold decision to freeze pay and prices, impose an import surcharge and suspend gold convertibility. Nor, without Connally’s urging, would Nixon have flipped from a policy of US international monetary leadership through the often slow-paced consensual hegemony to one of dramatic leadership through domination during August-November 1971. Connally’s political bravery rubbed off on Nixon, allowing Nixon-the-Cautious on economic issues to express himself as Nixon-the-Bold in economic affairs, matching his image on international security issues.

⁴⁹ Nixon’s offer was made on 4 December 1970. Connally’s appointment was announced publicly 10 days later.

⁵⁰ Burns, then a close confidant of the President, pronounced himself “absolutely stunned” Reeves, *Alone in the White House*, 285).

⁵¹ Haldeman, *Diaries*, 215

⁵² Frost and Zelnick, *Frost/Nixon*, 335

⁵³ Haldeman, *Diaries*, 395

⁵⁴ Safire, *Before the fall*, 497. From his vantage point as one of the economists in the Council of Economic Advisers Stein saw Connally frequently and was similarly smitten. He welcomed Connally’s arrival as changing the image of economic policy within the Nixon administration from the rather drab affair projected by a “scholarly and low key team of economic advisers” to one driven by Connally’s dynamism, “tall, handsome, forceful, colourful, charming, an excellent speaker ... and political to his eyeballs” (Stein, *Presidential economics*, 162). Connally’s arrival was not welcomed by all in Nixon’s economic team. Some, such as Shultz and McCracken who perhaps feared for the political influence they had built up with the President, displayed petty jealousies (Matusow, *Nixon’s economy*, 86 and 107). On 20 December 1970, having met Connally, Burns bemoaned the new Treasury Secretary’s lack of financial experience and policy vision (Burns and Ferrell, *Secret diaries*, 30-32).

Who was this star? Connally, decorated for valour during the Second World War, served as an aide to Eisenhower. After the War Connally trained as a lawyer, served as Secretary of the Navy under President Kennedy and was elected Governor of Texas.⁵⁵ He rode with Kennedy in the car in which the president was assassinated in 1963 and was wounded by one of the bullets that killed the President. That injury cemented Connally's national fame. His image was that of a suave gunslinger, capable of mixing socially with the East Coast Establishment, but also capable of brutal political aggression when necessary. Combative and adversarial by nature, he loved a fight. Connally's unsubtle approach to domestic politics and international relations was summarised in his remark to Kissinger "You will be measured in this town by the enemies you destroy. The bigger they are, the bigger you will be."⁵⁶

Connally was a Southern Democrat who had been left high and dry by his party's ideological shift to the left during 1964-72. His belief in a conservative rather than progressive approach to social issues, his dislike of "big government" and his contempt for trades unions was much closer to Nixon's ideology than to Democratic candidate, McGovern's, in the 1972 presidential elections.⁵⁷ Joining a Republican administration was not a huge ideological step for Connally; it was made easier by his belief in the over-riding political importance of members of the Cabinet demonstrating unity and backing the President's policies wholeheartedly.⁵⁸ One of Connally's favourite expressions was "I can play it round or I can play it flat, just tell me how to play it", a phrase that exemplified the policy flexibility Connally derived from his belief in unity, Presidential authority and the relative unimportance of ideology.⁵⁹

⁵⁵ Connally served as Governor during 1963-69.

⁵⁶ Quoted in Kissinger, *White House Years*, 951. Kissinger commented on this remark, adding Connally "relished combat in defence of his convictions."

⁵⁷ See a suspicious Burns' diary entry for 20 December 1970 for his summary of Connally's beliefs (Burns and Ferrell, *Secret diaries*, 32).

⁵⁸ Discussing his appointment to the Treasury, Connally wrote "State has the glamour, Defence has the toys, but Treasury is and always has been the most powerful job in the cabinet. Great decisions were waiting to be shaped, and I did not fear them... I never considered myself an economist, but I had the capacity to understand what the economists were saying. There were instincts to be applied and they were not mine alone. In the end, it was immaterial what position I took. My position was to sell the one the President took" (Connally and Herkowitz, *In history's shadow*, 233).

⁵⁹ Quoted in Stein, *Presidential economics*, 162. Connally meant what he said. For example, when Nixon reached agreements with French President Pompidou in the Azores in December 1971, reversing his position on a policy Connally had pursued doggedly on his behalf for four months, Nixon was worried Connally would be "put out" and told Haldeman to telephone

Connally was everything David Kennedy was not, and much that Nixon aspired to be.⁶⁰ Kennedy had failed either to make or “sell” the administration’s economic policy. He had not imposed himself on the Treasury, being seen as “nice but naive”.⁶¹ Connally, however, was a shrewd policy-maker and determined policy advocate. He approached the Treasury Secretary’s job from a primarily political perspective, sharing Nixon’s view the task was not reserved for those with financial or economic experience. This inclined Connally to interpret international economic issues from a domestic political perspective, biasing his perceptions against giving weight to international imperatives and towards giving weight to a decision’s domestic political ramifications.

Connally soon demonstrated his political and administrative skills in asserting the Treasury’s authority over all economic matters of interest to the administration. Like Nixon, he disliked committee and cross-Departmental decision-making processes which, in his view, led to caution and compromises.⁶² Connally sheltered his Department from bureaucratic rivals by moving economic decision-taking inside a bilateral relationship with Nixon: the pair met alone for an hour at least once a week. Nixon was glad to have someone who shared his view of the primacy of politics when making economic policy. He backed Connally’s demand that the administration speak with “one

him. When Haldeman did so he found “Connally could not have been more cheerful” (Haldeman, *Diaries*, 391).

⁶⁰ Kissinger saw Connally as “Nixon’s Walter Mitty image of himself. (Connally) was the one person Nixon never denigrated behind his back” (Kissinger, *White House Years*, 951).

⁶¹ British Chancellor Roy Jenkins’ description of Kennedy (Jenkins, *A Life*, 276). Safire, believed Kennedy “... proved to be neither strong in the inner council, nor persuasive outside it, and knew it.” (Safire, *Before the fall*, 498). Matusow describes Kennedy’s limited capacity to formulate economic policy and him being almost invisible as a policy advocate (Matusow, *Nixon’s economy*, 10).

Kennedy had risen through the ranks to become president of the Continental Illinois Bank of Chicago, the US’ 8th largest bank in 1969. He had served as an Assistant Treasury Secretary under Eisenhower, but only for one year. Kennedy was not one of Nixon’s friends. His main advantage from Nixon’s perspective was that he was from Chicago, not part of the East Coast or Wall Street Establishment that Nixon distrusted, and had had relatively little contact with Washington. This background, however, left Kennedy unprepared to run the Treasury, where he was disparagingly seen as “keeping bankers’ hours”, i.e. finishing work regularly by 5:30 pm.

Not all judgements of Kennedy were damning. Burns was content to have Kennedy as Treasury Secretary, at least initially, noting on 27 February 1969: “He continues to impress me favourably.” (Burns and Ferrell, *Secret diaries*, 15). Volcker, Kennedy’s Undersecretary for Monetary Affairs, praised Kennedy as “the epitome of honesty and openness” (quoted in Silber, Volcker, 70) and applauded Kennedy’s wisdom and decency (*Ibid.*, 75).

⁶² Shultz observed “Connally doesn’t consult, he operates” (Haldeman, *Diaries*, 399).

voice” on economic issues and made Connally his lead spokesman on economic affairs on 20 May 1971.⁶³

Connally’s working methods became clear when White House aide Peterson imprudently ignored Connally’s lead status in international monetary policy in November 1971. Connally reacted ruthlessly. He persuaded Nixon to move the protesting Peterson instantly to a post that left him unable to question Connally’s authority in future.⁶⁴ Even Haldeman was shocked by the speed and brutality with which the matter was handled.⁶⁵ Connally approached foreign opponents of US international economic policy the same way: head on!

Connally had a realist’s perspective on international relations, which he viewed essentially as a zero-sum game.⁶⁶ He believed the world needed US

⁶³ Ibid., 290. Stein, *Presidential economics*, 162-63, describes how Connally manoeuvred himself into this spokesman role and other members of Nixon’s economic team’s cynical reactions.

⁶⁴ Peterson was a Chicago-based businessman with stellar record of success in the camera business, attracting plaudits as “the most brilliant businessman of his generation” (Matusow, *Nixon’s economy*, 131). Nixon had lacked confidence in the Treasury prior to Connally’s arrival and was disturbed by the lack of coherence in US foreign economic policy. To rectify the latter he appointed an additional White House advisor, making him responsible for overseeing the administration’s approach to international economic issues; he would also run a new Council for International Economic Policy (CIEP), which Nixon had decided to establish in early 1971. When Peterson was proposed for the Advisor/CIEP roles Nixon agreed the appointment, albeit without enthusiasm, declaring: “He’d be alright. He wouldn’t bother me” (quoted in Matusow, *Nixon’s economy*, 132). Peterson was duly appointed as Nixon’s White House Assistant for Foreign Economic Relations and Director of the President’s Council for International Economic Policy in February 1971. Peterson, generally a peripheral figure in the administration, made his main contribution with his substantial report *The United States in the Changing World Economy*. He submitted this to Nixon as a secret report on 2 July 1971; it was published later that year. It drew together information on the US economy’s loss of international competitiveness since 1945, linking this to other states’ discriminatory foreign trade practices, notably in Japan and the EEC. The administration’s neo-mercantilists welcomed Peterson’s report: they could blame the US’ trade problems on other states’ unfair practices. Connally made great use of it. But Connally resented Peterson’s over-arching co-ordination role in the sphere of international economic and monetary policy. Connally responded brutally to Peterson’s intrusions on what he saw as his and Treasury’s turf. Hence the Treasury Secretary’s determination that Nixon should proclaim him the administration’s lead spokesman on all economic affairs. Once Connally had achieved this, Peterson’s defenestration from the White House inevitably followed, unceremoniously, in November 1971.

⁶⁵ Haldeman recorded how Nixon moved Peterson abruptly with “none of the usual courtesies” to become the new Secretary for Commerce (confirmed in that role by Congress in January 1972), adding “All of us agreed that this was about the most graceless exercise we had ever seen” (Haldeman, *Diaries*, 375). While it may appear odd to “relegate” an official from the White House staff by appointing him Secretary of Commerce, one has to bear in mind the outgoing Secretary of Commerce had achieved little influence over the president and even described his Department as being in “the backwaters of government” (Stans, *One of the president’s men*, 138); its senior officials assessed it was “neither a very useful Cabinet-level arm of government nor a particularly vital force in economic affairs” (Ibid., 138).

⁶⁶ Small reported that shortly after Connally had been appointed Treasury Secretary, he remarked “My view’s that foreigners are out to screw us and therefore our job is to screw them first” (Small, *Presidency of Richard Nixon*, 208). Gowa, *Closing the gold window*, 156, assesses Connally to have been an “economic nationalist”.

leadership.⁶⁷ A strong economy was a prerequisite for that.⁶⁸ If Connally had an economic ideology, it was mercantilist on trade issues; he had no fixed view as to how the international monetary system should be run, except that it should serve US interests.⁶⁹ The slogan “America First” might have been coined to describe his outlook. In Connally’s view, US allies were free riding: they drained the US of resources by paying too little for US-provided security; they maintained trade restrictions perhaps once necessary to help rebuild their economies in 1945, but by 1971 simply served to exclude US exporters from their markets; and, where markets were open to the US, allies undermined US competitiveness by clinging to under-valued exchange rates. Connally was appalled at the economic vulnerabilities the US had accumulated carelessly since 1945, undermining its ability to lead.⁷⁰ Connally did not value international economic agreements that perpetuated now-redundant US concessions, nor on the institutions these agreements spawned.⁷¹ In Connally’s opinion, it was time

⁶⁷ Connally told the American Enterprise Institute “The world is looking for the United States to assert its leadership. It does not require much travel around the world to realise the incredible dependency that the world feels towards the United States in terms of its leadership. If the free world has a leader, it is the United States, and if we falter or we fail, then every nation in the world that aspires to any degree of freedom will feel that it has been cut adrift, that it has no hope of help” (Connally, Conversation, 25).

⁶⁸ Connally observed: “we had to confront a very volatile international monetary system... throughout 1971, the US economy was in such distress, and the world monetary picture so volatile, that comparisons were being made with 1933... the pivotal year of the Great Depression. What was at stake was nothing less than the American role in a stable world society” (Connally, In history’s shadow, 236).

⁶⁹ Peter Flanagan, Counsellor to the President, commented: “All of us in the Nixon administration had a free-market orientation except John Connally, who really was not a philosophically dedicated free marketeer, and Arthur Burns” (Simon and Caher, Time for reflection, 100). Stein observed “(Connally) did not seem to have any preconception in favour of any particular policy” (Stein, Presidential economics, 162). Burns commented on 20 December 1970 the new Treasury Secretary’s lacked macroeconomic and international policy vision, the latter being in Burns’ opinion, “a matter of greatest importance in view of the probably proximity of a monetary upheaval” (Burns and Ferrell, Secret diary, 32).

⁷⁰ At the Camp David meeting that decided the US should adopt Nixon’s New Economic Policy and suspend gold convertibility, Burns protested the latter was unnecessary. Safire, Before the fall, 514, recorded the following exchange:

“Connally: What is our immediate problem? We are meeting because we are in trouble overseas. The British came in today to ask us to cover (guarantee) \$3 billion, all their dollar reserves. Anybody can topple us - anytime they want - we have left ourselves completely exposed... Why do we have to be ‘reasonable’? Canada wasn’t.”

Burns: “Allies can retaliate.”

Connally: “Let ‘em. What can they do?”

⁷¹ Connally’s disdain for the IMF and its Managing Director Pierre-Paul Schweitzer encapsulated his attitude towards international economic co-operation. On returning from his first visit to the IMF Connally stated he regarded it “as a museum in which anything that wasn’t already stuffed ought to be” (Coombs, Arena of international finance, 219). In an episode that mirrored Connally’s treatment of Peterson in November 1971, Connally was enraged by Schweitzer advocating publicly the US should make a contribution to solving its economic problems by devaluing the dollar. Connally believed it was for the US and the US only to pronounce on such matters. Coombs observed Schweitzer “was immediately moved to the

for the US' friends to redress the balance and help the US.⁷² "That's what friendships are for", he told a shocked American Bankers' Association conference in Munich in May 1971. He did not mince his words, nor use a velvet glove to hide the iron fist.⁷³ He favoured using US dominance to consensual hegemony to get what he wanted.⁷⁴ He brushed aside G10 allies' protests, remarking brusquely "the dollar is our currency but your problem." Connally's approach to international economic relations upset others in the Foreign Economic Policy Executive: William Rogers, Secretary of State, described Connally as a "gunboat diplomat".⁷⁵ But there was little they could do: Connally had the President's ear.⁷⁶

Henry Kissinger

Kissinger's memoirs include the admission "even in my most megalomaniac moments I did not believe that I would be remembered for my

most-wanted category on the Nixon administration's enemy list" (Ibid., 220). Connally let it be known the US would veto any attempt to reappoint Schweitzer when his term as Managing Director came to an end in 1972. Lord Cromer, British ambassador to the US (and former Governor of the Bank of England), wrote to the British Chancellor, Anthony Barber, in April 1972 warning him Connally "was not on speaking terms" with Schweitzer (Confidential and personal Letter from Lord Cromer to Chancellor of the Exchequer, 4 April 1972; Bank of England archive file OV53/42). Schweitzer was duly replaced at the IMF's Annual Meeting in September 1972.

⁷² Coombs, whose own efforts to foster co-operation with central banks abroad were complicated by Connally's methods, commented "Connally had long ago made clear his conviction that the United States had for decades shown a woolly-minded disregard of our foreign trading interests and that the time had come to bang the table and set accounts straight" (Coombs, *Arena of international finance*, 219).

⁷³ Connally commented on criticism that his language was sometimes too blunt, "I didn't believe you alienated people simply because they understood what you meant" (Connally and Herkowitz, *In history's shadow*, 240). But others thought it did. On 22 September 1971 William Rogers, Secretary of State, called Burns about Connally's "outburst" at a G10 finance Minister's meeting in London, complaining "Connally's ineptness in dealing with foreigners is leading to a collapse in US foreign policy" (Burns and Ferrell, *Secret diaries*, 57).

⁷⁴ Connally stated: "I thought we had a right to expect and even demand fairer trade arrangements, and more help from our allies in bearing the cost of their defence" (Connally and Herkowitz, *In history's shadow*, 240).

⁷⁵ Haldeman, *Diaries*, 320

⁷⁶ Burns commented on 20 September 1971 "Connally ... did not show enough understanding of the position of other countries, that there was a danger therefore that the position of other countries - which have pride as well as problems - will harden... that other countries are apparently in a process of establishing a common front against the US, that they have enough power to frustrate our economic objectives..." (Burns and Ferrell, *Secret diaries*, 56) Kissinger told Haldeman "Connally is like all Texans and is just basically anti-foreigner" (Haldeman, *Diaries*, 372). On 30 January 1972 Connally attempted to persuade the Cabinet to agree to impose "punitive measures" on states that had refused to accede to US requests for trade concessions. Burns opposed this and recorded a heated discussion "(Connally's) annoyance was obviously directed against me, but his bitterness was reserved for the 'damned foreigners' - and he raved on" (Burns and Ferrell, *Secret diaries*, 72-73).

contribution to the reform of the international monetary system.”⁷⁷ He was right about that. Yet his involvement ought to be remembered: though well-concealed, it was highly significant.

The President’s National Security Adviser may seem an odd choice for inclusion in the Foreign Economic Policy Executive, especially as Kissinger had proclaimed his own ignorance about economics and described his role in international economic policymaking as “peripheral”.⁷⁸ He focused on foreign policy and national security, yet found himself drawn into foreign economic policymaking at crucial moments. His interventions were intended to deliver consistency to US foreign policy and foreign economic policy by subordinating the latter to the former. Kissinger, an ideological Realist, always prioritised US security over economic interests.⁷⁹ Nonetheless, Burns valued Kissinger’s involvement in international monetary policy and complained his life was made harder by Kissinger’s sporadic involvement.⁸⁰

This policy co-ordination role resulted in Kissinger intervening decisively in foreign economic policymaking on three crucial occasions. He persuaded Nixon to end Connally’s drive for dollar depreciation in autumn 1971 because allies opposed Connally; this resulted in the Smithsonian agreement reconfiguring G10 states’ exchange rates. Kissinger also intervened twice in 1973 aiming to weaken Europe’s opposition to US security objectives. The first

⁷⁷ Kissinger, *White House Years*, 960

⁷⁸ Kissinger described his “economic” role in the Nixon administration: “My own participation in the economic deliberations during this period was peripheral. From the start I had not expected to play a major role in international economics, which - to put it mildly - had not been a central field of study for me. Only later did I learn that the key economic policy decisions are not technical but political.... I took a crash ‘tutorial’ from Professor Richard N. Cooper of Yale University to learn the rudiments of the subject. I appointed brilliant economists Fred Bergsten and Robert Hormats to my (NSC) staff. But on the whole I confined myself to a watching brief. Thus I attended meetings on the subject and I sent information memoranda to the President. But I did not seek to manage, much less dominate, the process of policy formulation as I did in other areas of national security.” (*Ibid.*, 950).

⁷⁹ Ferguson argues Kissinger was an “idealist” who learned the merits of Realism and its applicability to US circumstances through his studies of Bismark and de Gaulle (Ferguson, Kissinger, 727). Be that as it may, Kissinger certainly put US security ahead of all other foreign policy considerations, including ethical and moral concerns and, as noted above, economics, by the time he entered the White House.

⁸⁰ Burns and Kissinger met on 25 July 1972. Burns complained about Kissinger’s sporadic involvement in international monetary policy since December 1971, saying Kissinger’s absence “has made it difficult for me.” Kissinger responded by explaining US foreign policy and international monetary policy intersected briefly in November/December 1971: “The reason I could become involved last time was that we were moving towards the Summits (Nixon’s meetings with Pompidou, Heath and Brandt), and that imposed the need for a solution to the monetary problem. Also, I could tell the President that unless we did something, we were clearly headed for a crisis,” (Secret Memorandum of Conversation, 25 July 1972; Duncombe, *Foreign economic policy*, 639-43).

intervention resulted in G10 states adopting floating exchange rates in place of fixed rates in March 1973, the second scuppered an imminent agreement on international monetary reform in summer 1973.⁸¹ Quite an impact for a supposedly “peripheral” figure!

Kissinger cleaved to no particular economic ideology, but approached his national security co-ordination role from a conservative and Realist, albeit declinist, perspective. Like Nixon, he assessed “the age of superpowers is nearing its end”: he believed the US’ (and USSR’s) relative power was in decline.⁸² Kissinger expected the world to remain militarily bipolar for at least another ten years, but believed a system of political multipolarity was emerging as economic recovery in Europe and Japan boosted their relative power and China emerged as a military and economic power.

The unfamiliar juxtaposition of military bipolarity and political and economic multipolarity was, Kissinger believed, beginning to create new dangers. There was no internationally-agreed concept of what the new international order should look like. Moreover, the lack of agreement on the emerging international order implied current notions of legitimacy would gradually become redundant and cease to constrain states’ actions.⁸³ In these circumstances, Kissinger argued, the US should end its conviction that it alone had global “responsibilities” whereas other states merely had “interests”. He believed the US, like other states, had interests that should be pursued vigorously. These comprised: continued national military and economic strength; international stability; and peaceful change of the world order.⁸⁴ In particular, the US should work to ensure other major powers believed the international order respected their national interests; this would reassure them

⁸¹ It should be recorded that Kissinger’s fourth intervention in international monetary affairs, in December 1973, was a complete failure. Kissinger had been annoyed by Europe’s lack of support for the US’ response to the OPEC price increases and the Arab oil boycott. He tried to “punish” European states by refusing to allow senior US representatives to participate in a crucial Committee of Twenty international monetary reform meeting in Rome in January 1974. He failed: Treasury Secretary Shultz and Federal Reserve chairman Burns refused to co-operate with him and attended the meeting (Burns and Ferrell, *Secret diaries*, 113-14) .

⁸² Kissinger, *American foreign policy*, 56

⁸³ *Ibid.*, 57

⁸⁴ *Ibid.*, 92

they had a stake in the emerging international order and encourage them to help the US maintain it, not challenge it.⁸⁵

Kissinger believed a realist “balance of power” approach to diplomacy was appropriate. The five major powers would generate a stable balance of power over time, creating a new international order. (This would be along the lines later described by another Realist, Gilpin, in his model of hegemony.⁸⁶) Achieving peace through a balance of power would create its own sense of international legitimacy, at least among the major powers, just as the post-war period of bipolarity had created its own legitimacy.

Kissinger argued post-1945 structural changes in the world order would create new challenges for the US. Three of these proved to be particularly relevant to the international monetary sphere:

- the relative decline in US power was creating “a profound crisis” in the US’ alliances. De Gaulle had demonstrated Washington should no longer take allies’ support for granted. Political multipolarity required alliance consensus and unity to be created pro-actively, not simply asserted by Washington;⁸⁷
- the concept of “fairness” inherent in post-1945 agreements between the US and its allies was breaking down. New attitudes were emerging as international structures changed. Kissinger warned burden-sharing agreements would not create a sense of alliance unity because “states do not assume burdens because they are fair, only because it is necessary”.⁸⁸ This sense of the growing unfairness of some arrangements cut both ways of course. While US allies might resent some of the economic and military burden-sharing agreements accepted in earlier days, by the early 1970s the US too wished to redefine what it felt was “fair” as regards trade, defence and exchange rate arrangements; and,
- emerging political and economic multipolarity implied there would no longer be a single, Washington-centric, perspective on the interests of

⁸⁵ As in Mearsheimer’s definition, major powers can be regarded as states capable of defending themselves against their peers and/or of deterring potential attackers by imposing unacceptable costs on states minded to attack them.

⁸⁶ See Gilpin, War and change, discussed in chapter 2 above.

⁸⁷ Kissinger, American foreign policy, 70

⁸⁸ Ibid., 71

the “Free World”. Europe and Japan had their own views and would have a growing say on such matters. As Kissinger saw it, the challenge for Washington was to determine “how much unity do we want, how much diversity can we stand?”⁸⁹

White House staff never doubted Kissinger’s brilliance as an international relations analyst.⁹⁰ The Washington diplomatic community shared this view of Kissinger, although trust was always an issue.⁹¹ Nixon appreciated Kissinger’s negotiating skills and his ability to identify opportunities for gaining diplomatic leverage by using carrots and sticks to incentivise other states to do what the US wanted, and by “linkage”, intended to ensure the US maximised its advantages in diplomatic negotiations by making its power as fungible as possible. Kissinger was initially seen as Nixon’s foreign policy “implementer”; later he was recognised as a perceptive strategist in his own right.⁹² Yet he proved to be a difficult member of the administration, perpetually insecure and constantly seeking reassurance from Nixon and senior White House staff

⁸⁹ Kissinger, *White House Years*, 78

⁹⁰ Haldeman wrote “Kissinger was a brilliant theorist who could place every problem in perspective and use historical precedent to help evaluate suggested options” (Haldeman, *Diaries*, 110).

⁹¹ Sir Michael Butler remarked on both aspects of Kissinger’s character as he recalled for the British Diplomatic Oral History Programme his time as a Counsellor in the British Embassy in Washington in 1971. Butler described Kissinger as “virtually the only person worth seeing” on diplomatic business in Washington, but Kissinger’s comments could not be taken at face value: “One had to study every statement he made in public or private very carefully. I mean he was simply incapable of being truthful. He really couldn’t tell the difference. Or perhaps he knew what he was saying.” Butler had been tipped off about Kissinger’s unreliability by Bob Bowie, President of Harvard’s Centre for International Affairs and one of Kissinger’s academic colleagues. Bowie warned Butler “Henry can’t tell the difference between truth and falsehood.” See the electronic archive of the British Diplomatic Oral History Programme, kept by Churchill College, Cambridge at: <https://www.chu.cam.ac.uk/media/uploads/files/Butler.pdf>

An example of Kissinger’s duplicity is recorded in a Top Secret Memorandum of Conversation (between President Pompidou and Kissinger in Paris), 18 May 1973 (Rasmussen, *Foreign Economic Policy*, 133-38). Kissinger told Pompidou US “technical experts” (presumably Shultz and Volcker) “pressed (Nixon) for organising Germany against France and a confrontation based on the idea of a divided Europe... (However) I recommended that we discuss these matters with you in a broader context.” In fact it was Nixon and Kissinger, not US “technical experts”, who were aiming to profit from a “divide and rule” strategy in Europe. Nixon and Kissinger were attempting to sabotage European integration and divide European states by luring them into a self-destructive joint currency float against the dollar in spring 1973. US Treasury experts believed a joint European currency float, adopted in March 1973, would be unsustainable. Its collapse would destroy Europe’s first attempt at monetary union. This, Nixon and Kissinger hoped, would severely damaging European integration and European unity. Kissinger was hoping to profit from this: he looked forward to exploiting European divisions to help him achieve his objectives in his Year of Europe negotiations (see chapter 6 below).

⁹² Haldeman described how the Nixon-Kissinger foreign policy roles changed over time. Initially “Nixon was the leader and strategist, Kissinger the implementer” (Haldeman, *Diaries*, 110). This gradually changed with Kissinger playing an increasingly strategic role.

colleagues.⁹³ His grip on the concept of secrecy was precarious. He was secretive, yet unable to keep secrets. He often refused to share information with administration colleagues who might have used it fruitfully, while he was often garrulous and indiscrete with those who had no operational need for sensitive foreign policy information, such as journalists, academics and Washington's social elite. His feud with Nixon's Secretary of State, William Rogers, blew hot and cold throughout Nixon's time in office.⁹⁴ Some of the Kissinger/Rogers rivalry was attributable to the structural tensions Nixon created by distancing the State Department from the most important foreign policy decisions, reserving them for the White House.⁹⁵ Even so, Kissinger's behaviour at times maddened and wearied colleagues, and even Nixon, lessening Kissinger's influence at times.

Nixon's economists: Burns, McCracken, Shultz and Volcker

Nixon appointed his economic team and expected them to run the economy at as near to full-employment as they could manage. The economic

⁹³ Haldeman observed Kissinger was "Funny, emotional, brilliant in his job. Henry was a winner all the way. Yet he was strangely insecure, which led to his famous outbursts against Bill Rogers, a quiet man who was no match for Henry in any war of words" (Ibid., 124). Kissinger knew how colleagues perceived him: he told David Frost Nixon viewed his National Security Adviser as "a sort of neurotic genius in need of strong leadership" (Frost and Zelnick, Frost/Nixon, 74). This self-awareness, however, did not enable Kissinger to control his actions. Haldeman's diaries record a succession of rows between Kissinger and Rogers, many resulting in Kissinger threatening to resign, and two occasions on which Nixon decided Kissinger should depart. Haldeman's diary entry for 17 August 1970, for example, records a "bitter and uptight" Kissinger, complaining about Rogers and the State Department "playing games with him", caused Nixon to worry about Kissinger's "weird persecution delusions" and how these may be affecting the reliability of his National Security Adviser's judgement and policy recommendations, causing Nixon to assess Kissinger "had reached the end of his usefulness" (Haldeman, Diaries, 189). This scenario is played several times in Haldeman's diaries.

⁹⁴ Kissinger succeeded in "outliving" Rogers in the administration because Nixon sacked Rogers and replaced him with Kissinger as Secretary of State a year before resigning.

⁹⁵ Nixon and Kissinger distrusted the Federal bureaucracy. Buchan observed Kissinger believed in diplomacy and knew a great deal about its history, but "he does not believe in using the services of diplomats" (Buchan, "Irony of Henry Kissinger", 377). Nixon shared Kissinger's prejudices on this and asked Kissinger to deal personally with the high priority foreign policy issues, including Vietnam, East-West relations and China, leaving routine tasks to the State Department and Secretary of State, William Rogers. Rogers, a lawyer who helped Nixon by employing him after electoral defeat in 1960, was chosen for the position precisely because he was low-key and could manage a bureaucracy. Rogers and his State Department officials were often blindsided by Kissinger's (Nixon-agreed) use of "back-channels" to convey sensitive information and policy initiatives, resulting in much confusion within the administration and frequent tensions between Kissinger and Rogers. This policymaking structure frustrated both Rogers, through his exclusion, and Kissinger, because of his inability to control and co-ordinate the entirety of US foreign policy, which he believed was essential if it were to be effective.

team's personnel varied over time, but four - all academically trained economists - stand out for their influence over foreign economic policy: Arthur Burns, chairman of the Federal Reserve Bank, Paul McCracken, chairman of the Council of Economic Advisers (CEA), George Shultz, who rose to be Nixon's "economy czar", and Paul Volcker, Treasury Undersecretary for Monetary Affairs.

The four men had widely different political views. McCracken was firmly on the Republican Party's right wing: an economics professor at the University of Illinois, he and the University of Chicago's Milton Friedman, were leading members of a conservative group aiming to convert the American Enterprise Institute into a "brains trust" tasked with teaching their free market ideology to political leaders.⁹⁶ Burns and Shultz were mainstream Republican moderates, Volcker a Democrat. Their political views were of little concern to Nixon. He appointed them for their economic competence, allied to their experience of government and their knowledge of how to operate the Federal system.⁹⁷

None of the four specialised in international economics: Burns was an expert on business cycles; McCracken on macroeconomics; Shultz was a labour economist; and Volcker was a financial specialist.⁹⁸ These differences mattered less than their different economic ideologies.

⁹⁶ Micklethwait and Wooldridge, *The right nation*, 49-50

⁹⁷ McCracken had spent most of his working life in academia, but also had stints as a research economist with the Federal Reserve Bank of Minneapolis, an economist on the Council of Economic Advisers in the Eisenhower administration (1956-59) and served on two working groups in the Kennedy administration before Nixon appointed him (on Burns' recommendation) as chairman of the Council of Economic Advisers (1969-71). Burns had taught and researched economics at Rutgers and Colombia Universities and the National Bureau of Economic Research; he had been chairman of the Council of Economic Advisers in the Eisenhower administration (1953-56) and marked time as a Counsellor (on domestic affairs) to the President in 1969 before being appointed chairman of the Federal Reserve Bank (November 1969-1978). Shultz taught economics at the University of Chicago, rising to become Dean of the Graduate School of Business; he had earlier served as a senior staff economist in the Council of Economic Advisers (1955) and was appointed as Nixon's Secretary for Labour (1969-70), director of the Office of Management and Budget (1970-72) and Treasury Secretary (1972-74), combining that with wide-ranging responsibilities for economic policy in 1973-74. Volcker alternated between working for Chase Manhattan bank on Wall Street and the public sector, where he worked as a research economist for the Federal Reserve Bank of New York (1952-57), director of financial analysis at the US Treasury (1962), and Deputy Undersecretary of the Treasury for Monetary Affairs (1963-65) before being appointed as the Undersecretary for Monetary Affairs (1969-74).

⁹⁸ Burns recorded his impressions of a meeting held on 26 November 1971 to discuss preparations for what would become the Smithsonian agreement: "Here we were - Kissinger, a brilliant political analyst, but admittedly ignorant of economics; Connally, a thoroughly confused politician, suppressing his desire to punish foreigners in view of the President's moving away from narrow domestic political considerations; Shultz, a no less confused amateur economist; I,

Nixon's presidency coincided with the breakdown of the economists' consensus over macroeconomic theory. Keynesian economic theory held sway after 1945, but a determined and radical "monetarist" challenge from Milton Friedman and his colleagues, the "Chicago Boys", had fractured the profession's consensus by 1969.⁹⁹ The differences between Keynesian and monetarist camps turned on how they regarded markets. Drawing on their analysis of the Great Depression in the 1930s, Keynesian economists did not believe markets would always "clear", i.e. prices would not always match supply and demand. Governments could play a constructive role by intervening at the macroeconomic level to achieve a level of total spending that would create full employment. Governments had to be careful about how they managed spending, however, because excess spending (relative to the economy's productive capacity) would create inflation; insufficient spending would lead to unemployment and/or price deflation. It followed from this that high rates of inflation (due to excessive spending) could not co-exist with a recession (caused by insufficient spending). Keynesian theory argued "stagflation", the combination of recession and high inflation, was impossible.¹⁰⁰

Monetarists took the opposite view. They believed markets ought always to "clear". Any exceptions, including those generating unemployment, were probably due to government interference with market forces. Governments were usually the problem, not the solution, especially when they over-expanded the money supply.¹⁰¹ This would create inflation, corrupting the information

the only one with any knowledge of the subject, but even then not a real expert on some aspects of the international economic problem. What a way to reach decisions! No one from the State Department there, no technical experts to aid us!" (Burns and Ferrell, Secret diary, 66). This appears to have been a Quadriad meeting in which, very unusually, Kissinger represented the President.

⁹⁹ Friedman's ideas appeared radical and outlandish in the 1960s. Micklethwait and Wooldridge commented: "Many of the people the Right now hails as intellectual giants were widely dismissed at the time (1964) as eccentric pygmies. The Ivy League establishment looked down on 'Chicago Boys'. The then-respected Robert Lekachman brusquely dismissed the Chicago School as nothing more than an 'ingenious sect'. Some Keynesian economists successfully lobbied to get Friedman's *Capitalism and Freedom* purged from university libraries" (Micklethwait and Wooldridge, *The right nation*, 60).

¹⁰⁰ Greenspan, *Age of turbulence*, 72, discusses the controversy in macroeconomic theory.

¹⁰¹ A qualification here: even Friedman accepted there could be structural market failures justifying government intervention. But these would be relatively rare, confined to instances of information asymmetries, externalities, sectors in which production was subject to increasing returns to scale and distortions resulting from severe income distribution inequalities.

contained in price signals and disrupting markets, thereby damaging an economy's growth and employment.¹⁰²

The Keynesian/monetarist theoretical controversy had important implications for international monetary policy and the Bretton Woods regime's prospects. Keynesians, who regarded markets with less reverence than monetarists, were content for a government to dictate the economy's most important price - the exchange rate - by establishing a fixed exchange rate and instructing their central bank to maintain that price irrespective of foreign exchange market pressures. Monetarist economists believed the market for foreign exchange was simply another market and deplored central banks' blocking market forces by fixing prices. They argued buyers and sellers should be free to establish the price of foreign exchange; central banks and governments should not meddle with market forces.¹⁰³

Burns and Volcker were Keynesian economists when they joined the Nixon administration.¹⁰⁴ They had a strong attachment to fixed exchange rates and the Bretton Woods regime. Shultz joined the Nixon administration directly from the University of Chicago and championed Friedman's ideas.¹⁰⁵ Shultz believed markets, including capital markets, should operate freely and exchange rates should be flexible. He believed the Bretton Woods regime's designers, Keynes and White, had made the wrong strategic choice in 1944

¹⁰² Neither producers nor consumers would know whether an increase in a commodity's price was due to a shortage of the commodity in question, in which case producers should be trying to profit by increasing its supply, or due to the general rise in prices that constitute inflation, in which case no increase in the commodity's production would be warranted.

¹⁰³ Milton Friedman's *The Case for Flexible Exchange Rates* was path-breaking in post-1945 economics.

¹⁰⁴ Peter Flanigan, Counsellor to the President (Nixon), commented "Arthur (Burns) was not comfortable letting the market manage itself..." (quoted in Simon and Caher, *A time for reflection*, 100).

¹⁰⁵ Friedman's impact on Washington was limited until Shultz's arrival. Odell described how "The Friedman policy (of floating exchange rates) was not seriously discussed in the Johnson administration Treasury" because floating was viewed as a threat to US trade and overseas investments - the prevailing economic orthodoxy at the time (Odell, "Emergence of flexible exchange rates", 66). Friedman got his foot in the door by recommending Shultz's appointment to Nixon when the latter was seeking an expert to serve as Secretary of Labour. Once in Washington, Shultz kept in contact with Friedman on a more frequent basis than Nixon (who had consulted Friedman during his 1968 presidential election campaign and occasionally invited Friedman to the White House for private consultations on economic policy). Shultz relayed the professor's thinking into the administration's policy discussions and shared official information with Friedman. Foreign Economic Policy Executive members knew this. In August 1971, for example, Nixon instructed Connally to bring his troika colleagues, McCracken and Shultz, up to speed on the proposed New Economic Policy package to be discussed at Camp David. He also told Connally to warn them not to leak the information "And that means telling Shultz that he cannot talk to Milton Friedman" (Silber, Volcker, 83).

when confronting the Mundell trilemma.¹⁰⁶ They had designed their regime to combine national monetary independence with fixed exchange rates and no, or at most low, levels of international capital mobility. Shultz wanted national monetary independence to be paired with free capital mobility and floating exchange rates. He frequently lobbied Nixon to make good his 1968 election campaign promise to end US controls on capital outflows.¹⁰⁷ McCracken, who had co-operated closely with Friedman at the American Enterprise Institute, was for the most part on Shultz's side, although sometimes sceptical about turning Friedman's theories into practice. McCracken described his economic views as being "Friedmanesque" rather than fully "Friedmanite".¹⁰⁸

The philosophical differences spilled over into the personal relationships between the four men, complicating their policy debates in the Foreign Economic Policy Executive.¹⁰⁹ However, they each generally behaved

¹⁰⁶ Mundell's "trilemma" is discussed in chapter 1.

¹⁰⁷ Shultz lobbied Nixon persistently to deliver on his 3 October 1968 election pledge to eliminate President Johnson's capital controls. Archive material shows Shultz began his lobbying at a CCEP meeting on 24 January 1969: see Confidential Action Memorandum from Richard Cooper and Fred Bergsten to the President's Assistant for National Security Affairs, Kissinger, of 28 January 1969; (Duncombe, Foreign economic policy, 5-6). Then, as on many subsequent occasions, Shultz lost the argument because members of the Cabinet believed any relaxation of controls on US capital outflows would be economically and politically costly: relaxing US controls on capital outflows would weaken the dollar's exchange rate and annoy European governments and Japan. Shultz did not persuade Nixon to abolish US capital controls until February 1973, with controls lifted at the start of 1974.

¹⁰⁸ Stein, *Presidential economics*, 139. McCracken usually advocated pro-market policies, including pollution charges in preference to regulation; a volunteer army (i.e. market-based recruitment) rather than conscription; and abolition of regulatory controls on trade, capital flows and exchange rates, including adoption of floating exchange rates (*Ibid.*, 144).

¹⁰⁹ Shultz's liberal economic views tended to win him support from the similarly liberally-minded economists in the Council of Economic Advisers, but faced strong opposition from the Treasury - Volcker found Shultz patronising at times - and especially from Burns at the Federal Reserve (Silber, Volcker, 76). While Burns' views of Shultz softened during Nixon's second, abbreviated, term, Burns evidently loathed Shultz during Nixon's first term. Policy differences were at the heart of this: Shultz sometimes acted as Nixon's messenger, clamouring for a more expansionary monetary policy, and Shultz favoured floating exchange rates whereas Burns remained wedded to fixed rates and the Bretton Woods regime. On 24 November 1970 Burns questioned Shultz's honesty, describing him as a "calculating manipulator" (Burns and Ferrell, Secret diary, 30). While recognising Shultz's "genius for mediation", Burns deplored the skills and aptitudes necessary for this, including Shultz's "sense of expediency", which Burns felt threatened to undermine Nixon (*Ibid.*, 33). Nor did Burns rate "the fanatical Shultz" as an economist, describing him as a "woefully ignorant ideologist (and) confused amateur economist" (*Ibid.*, 38 and 66). Burns was similarly disobliging towards McCracken, commenting "Too bad that he worries so much about his status", as if an economic adviser with no large Department or staff to support him could be indifferent to such matters (*Ibid.*, 8).

Shultz was happy to retaliate in kind against Burns. Shultz needled Nixon about Burns at a Cabinet meeting on 13 April 1970, warning "Arthur (Burns) has a way of holding the money supply a hostage - saying that 'if you don't behave (on fiscal policy), I'll tighten up on money' and in fact in that way he's trying to run the whole Executive Branch with the Federal Reserve." Nixon rose to Shultz's bait, responding "When we get through this Fed won't be independent if it's the only thing I do in this office" (quoted in Matusow, *Nixon's economy*, 62). Shultz

pragmatically, not ideologically, in the sense that they were willing to temper their economic ideologies to the requirements of practical politics.¹¹⁰ And, for better or worse, each of the four men brought to the Foreign Economic Policy Executive something additional to their economic expertise and pragmatism.

McCracken, experienced as a leading lobbyist for conservative economic causes, brought leadership and political visibility to Nixon's initial economic team.¹¹¹ He dominated the troika during 1969-70, yielding only to Connally's dominating personality in 1971.¹¹² McCracken used his early influence on Nixon to establish a "gradualist" anti-inflation policy, bearing down on inflation

continued to goad Nixon into criticising Burns. At a 14 February 1972 meeting taped in the White House that excluded Burns, Shultz encouraged Nixon to press for further monetary expansion: "The economy has to be good, (a) strong expanding economy this year. So much is at stake on this. He (Burns) recognises that and he needs to do everything he can do. We want low interest rates! What's the problem there? So we don't have a return flow of money from Europe? So what? Keep the money supply going up!" (quoted in Abrams, "How President Nixon pressured Arthur Burns", 183).

Nixon's trust in Burns had evaporated by summer 1971. Nixon's antagonism towards his "disloyal" old friend led him to instruct White House aide Colson on 5 July 1971 to blacken Burns' name. Haldeman records Nixon telling Charles ("Chuk") Colson "we're going to have to start playing a harder game with Arthur (Burns)" (Haldeman, *Diaries*, 314). The upshot was that Colson leaked stories to the media about the Federal Reserve risking losing its independence from the Executive Branch and - especially hurtful to Burns as his diaries record - that Burns had publicly urged pay restraint on others while privately requesting a \$20,000 increase in his \$42,500 salary; Burns retaliated by refusing to take calls from the White House (Reeves, *Alone in the White House*, 389). Both Nixon and Burns issued press releases expressing transparently insincere appreciations of the other's worth to the US when markets showed their alarm at the threatened loss of Federal Reserve Bank independence, but the damage had been done to working relations within the Foreign Economic Policy Executive.

The various tensions and rivalries persisted, providing an uncomfortable background to discussions between members of the Foreign Economic Policy Executive.

¹¹⁰ This pragmatism is common in those who reach the highest offices of state. Policy makers must deal with many events that are not well-captured by theories or models set out in text books and, moreover, must do so under circumstances of uncertainty and from initial positions that might at most be described as "second best", not the ideal, "first best" circumstances that are often the initial positions assumed when models are outlined in text books.

¹¹¹ Reichley describes how McCracken made himself the troika's leader and spokesman by dealing with political pressures and the media limelight in a way that his colleagues, David Kennedy and Robert Mayo, could not (Reichley, *Conservatives*, 207). Herbert Stein described Mayo as being "mild and retiring" and a "matched pair" with Kennedy, who was almost "politically invisible" (quoted in Matusow, *Nixon's economy*, 11). Stein was well placed to judge: he was appointed a member of the Council of Economic Advisers in 1969 because of his expertise on fiscal policy. Nixon appointed him its chairman in 1972 following McCracken's resignation. Stein's account of events in his *Presidential economics* supports Reichley's interpretation of developments in the troika in 1969-71.

¹¹² Nixon lost confidence in his economic team because they permitted a recession to develop at the end of 1969, and thus failed to generate the prosperous economic climate he believed would give the Republican candidates their best chance in the 1970 congressional elections. Nixon replaced Mayo with Shultz in July 1970, creating the new position of Director of the Office of Management and Budget at the same time; Nixon sacked Kennedy in November 1970, making room for Connally at the Treasury; and, disillusioned and eventually marginalised, McCracken resigned and left the administration at the end of 1971. He was replaced by Herbert Stein, whose over-riding interest in fiscal policy and domestic matters precluded him from having a substantive impact on the US' foreign economic policy.

by tightening fiscal and monetary policy incrementally. This achieved only modest success against inflation, but resulted in a flow of gold *into* the US and kept the world free of foreign exchange market crises. With the US at last meeting its Bretton Woods responsibility to run a “sound”, low-inflation, macroeconomic policy after the Johnson administration’s monetary excesses, and Washington consulting allies on international monetary reform, the regime appeared to be in safe hands at the end of 1970, not heading for a crisis.

Burns was a chameleon character, domineering within the Federal Reserve, yet compromising its independence by yielding to White House demands for an expansionary monetary policy.¹¹³ Burns defended Bretton Woods with words, not deeds. Bretton Woods needed “sound money” policies from the Federal Reserve, but Burns prioritised Nixon’s re-election and nurtured the economic boom Nixon craved with an expansionary monetary policy. Aware he was adding to the stock of foreign-held dollars that was not backed by gold, and fearing the inflationary risks he was creating, Burns tried to persuade Nixon to impose an economy-wide prices and wages freeze in 1970, an extreme Keynesian anti-market policy.¹¹⁴ Burns hoped a freeze would prevent money supply increases from feeding inflation, thereby maximising its expansionary impact on spending and employment, while also reassuring foreign dollar holders. Burns failed to persuade Nixon and inflation increased, precipitating a flight from the dollar in foreign exchange markets in May 1971. The crisis resumed in August. Nixon responded by freezing wages and prices, as Burns had wished, but the delay, combined with Burns continued reckless money supply increases, had undermined the Bretton Woods regime. Burns’ involvement in negotiating its replacement was minimal.¹¹⁵

¹¹³ The Federal Reserve Bank is run by its Board and the Federal Open Markets Committee (FOMC). James Pierce was a senior staff member who attended both Board and FOMC meetings during 1969-75. He reported that “for all intents and purposes, monetary policy was Burns. His colleagues on the Board and FOMC exerted little influence on monetary policy” (Pierce, “Political economy of Arthur Burns”, 485).

Abrams catalogues this pressure, drawing heavily on the evidence in the White House tapes of telephone conversations between Nixon and Burns (see Abrams, “How President Nixon pressured Arthur Burns”). Poole’s, “Burnsian monetary policy”, and Pierce’s, “Political economy of Arthur Burns”, cover similar ground. The latter approaches the matter from the Federal Reserve’s perspective. Reeves’ *Alone in the White House* makes extensive use of Haldeman’s diaries as it provides further evidence of Nixon’s incessant demands on Burns for monetary expansion.

¹¹⁴ Reeves, *Alone in the White House*, 287

¹¹⁵ Wells commented on Burns’ limited contribution to building a new international monetary order: “(Burns was) not a regular member of the Committee of Twenty. He attended

Shultz was formidably successful within Nixon's administration. He was able to outlast rivals due to his staying-power and administrative skills, his negotiating tactics were better than the confrontational Connally's, and he understood structural power. Shultz had been seen as "the greyest of the grey" in a lacklustre cabinet when Nixon appointed him Labour Secretary in 1969.¹¹⁶ The longer he stayed in the administration, however, the more responsibilities he accumulated, rising to become Nixon's "economy czar" in 1973.¹¹⁷ He was the last of Nixon's original cabinet to resign.¹¹⁸

Shultz, despite his Friedmanite preference for flexible exchange rates and free capital mobility, did more to save the Bretton Woods regime than Burns, ostensibly its champion in Washington. On being appointed Treasury Secretary in 1972, Shultz was aware his preferred free market-based international monetary order was unacceptable to the US' allies. Nor did he wish to impose his preferred monetary order by dominating allies. Shultz invariably sought progress through consensual hegemony, reflecting his industrial relations negotiating background. He limited his international monetary reform objectives to those broadly acceptable to allies, which meant setting aside his free market principles on exchange rates.¹¹⁹ He came within an ace of reviving the Bretton Woods regime in summer 1973. Had Kissinger not intervened to disrupt Shultz's negotiations in the Committee of Twenty, it is likely he would have obtained the reform he was working to achieve.¹²⁰

Shultz achieved an important shift in US international monetary strategy, from Connally's attempt at hegemony through domination to one of

several meetings, but did not participate in the regular work... Burns' talents were not really appropriate to the tasks of the Committee. It was taking an intellectual step in the dark, devising something completely new... Burns was not very good at this sort of thing – he was an able economist, historian and formidable critic, but his mind was not especially original" (Wells, *Economist in an uncertain world*, 96).

¹¹⁶ *Newsweek's* description of Shultz (quoted in Matusow, *Nixon's economy*, 27).

¹¹⁷ In 1973 Nixon restructured and streamlined his administration, appointing Shultz Secretary for Economic Affairs as well as Treasury Secretary and Counsellor to the President. The media soon dubbed Shultz Nixon's "Super-Secretary" and "economy czar".

¹¹⁸ Shultz, disillusioned by Nixon's handling of Watergate and exhausted by his role as all-purpose economic workhorse, resigned in March 1973, telling Nixon "I'm just pooped" (Nixon, *Memoirs*, 908-09).

¹¹⁹ Volcker admitted his surprise when Shultz, on being appointed Treasury Secretary in 1972, instructed him to draft a plan for international monetary reform, telling Volcker he wanted "something that has a chance to work. A consensus" (Silber, Volcker, 112). Volcker had expected to be instructed to prepare a plan for introducing flexible exchange rates.

¹²⁰ Shultz's was aiming to secure an international agreement on a new, fixed exchange rate, SDR-based Bretton Woods regime and the restoration of gold convertibility.

hegemony through consensus.¹²¹ Shultz also replaced Connally's preference for the "frontal assault" with his "indirect manoeuvre". This reduced frictions between the US and allies, facilitating agreement on the complex subject of reforming international monetary structures. Stein's description of Shultz revealed he personified Strange's concept of structural power:¹²²

"(Shultz) knew that the object (of government) was to translate ideas into actions. And he knew this process would not be easy. If the conditions for doing so had been favourable, it would probably have been done. Therefore he was concerned with changing the conditions where he could, and where he could not, adapting the ideas so as to get as much as the unchangeable conditions would permit. This gave his actions a malleability that his (Friedmanite) ideas might not have had."¹²³

Volcker brought technical expertise to the Foreign Economic Policy Executive.¹²⁴ Greider likened Volcker to a senior British civil servant: a career man, steeped in government who outstays the "here today, gone tomorrow" politicians and accumulates influence by acquiring policy expertise and knowledge and by being willing to accommodate others' views by setting aside his own policy and ideological preferences.¹²⁵ Members of the Foreign Economic Policy Executive valued Volcker for his grasp of international finance and financial policy, not his political skills, which he freely admitted were underdeveloped.¹²⁶ Volcker's understanding of the international financial

¹²¹ Discussed in chapter 2

¹²² Discussed in chapter 1

¹²³ Stein, *Presidential economics*, 146

¹²⁴ Nixon was temperamentally averse to appointing "East Coast intellectuals" to his administration but made an exception for Volcker, who was recommended to Nixon by a man the president trusted: Charles Walker, head of the American Bankers Association. Nixon regretted his choice, never fully trusting Volcker. He viewed Volcker as being unreligiously close to the Treasury bureaucracy and its interests. Perhaps worse, but ironically in view of Nixon's preferences, Nixon saw Volcker as being too focussed on international affairs and foreigners' interests: "he's so obsessed by things international"; Nixon feared Volcker wanted to "sacrifice the domestic economy to save the dollar: I am not in favour of that" (Silber, Volcker, 84).

¹²⁵ Greider, *Secrets of the temple*, 68

¹²⁶ Volcker had gained some political experience during his time as Deputy Undersecretary for Monetary Affairs, including attending meetings with lobbyists and Congressional committees. He admitted it had been "an interesting lesson" in his political education seeing tax lobbyists convert an initially sensible Treasury tax proposal into an unworkable mess in 1963 (Volcker and Gyohten, *Changing fortunes*, 33). Nonetheless his political antennae remained underdeveloped and his continuing political naivety in 1971 is revealed in three examples of what he called his political education on the job in the Nixon administration. First, he had been present at the American Bankers Association's annual

machine, and its tolerances, was invaluable. His detailed technical analysis and preparations made it possible to develop a consensus within the Foreign Economic Policy Executive around Nixon's Camp David policy package, albeit at the expense of the Bretton Woods system Volcker had valued highly and had worked to preserve.¹²⁷ Volcker's technical expertise persuaded Kissinger, as one of the first acts of the Nixon administration, to appoint him head of a new working group tasked with examining US policy options in international monetary affairs. Volcker's expertise also enabled him to help Connally prepare the "New Economic Policy" package agreed at Camp David in August 1971 and Shultz prepare his 1972 plan for international monetary reform.¹²⁸

Ford Administration: Structures

President Ford "inherited the biggest mess ever left behind by a modern president", and did so without an opportunity to prepare.¹²⁹ Ford was sworn in as president the day after Nixon's abrupt resignation on 8 August 1974. He

meeting, held in Munich in May 1971, where Connally definitively ruled out dollar devaluation. Volcker worried this might prove unsustainable and was taken aback when Connally told him "That's my unalterable position today. I don't know what it will be in summer" (Ibid., 75). Second, Volcker had been surprised by the way Nixon, a "masterful politician" in Volcker's eyes, had used rhetoric to convince the US public to regard the Camp David decisions in August 1971 as a triumph rather than being the consequence of US relative economic decline (Ibid., 80). And third, Volcker, not taking account of the damage the Camp David measures had done to the US' relations with its allies, expected agreement to be reached on a new G10 exchange rates by the end of September 1971. A wiser Connally correctly informed him it would take months to bring US allies to the point where they would agree new exchange rates (Ibid., 80).

¹²⁷ Although Volcker recommended to Connally and Nixon that the US suspend gold convertibility in August 1971, and supported this decision at the Camp David meeting Nixon convened to discuss the matter with his economic experts, Volcker regarded the move as a bitter defeat for the US: "I was not prepared to accept passively that the breakdown (of the Bretton Woods regime) would be inevitable within a single generation, nor do I believe this today" (Ibid., 63). He agonised about whether the US should have done more to respect the Bretton Woods regime's disciplines when designing its domestic economic policy and whether the US should have heeded the warning signs from the foreign exchange markets about the dollar (Ibid., 61-62). Safire painted a vivid picture of Volcker's emotions at the Camp David meeting: "Volcker was undergoing an especially searing experience. He was schooled in the international monetary system, almost bred to defend it; the Bretton Woods Agreement was sacrosanct to him; all the men he grew up with and dealt with throughout the world trusted each other in a crisis to respect the rules and cling to the few constraints like convertibility of gold. Yet here he was participating in the overthrow of all he held permanent; it was not a happy weekend for him" (Safire, *Before the fall*, 518).

¹²⁸ As discussed in chapter 7 below, the US international monetary reform plan Shultz put to the Committee of Twenty in 1972 was essentially "Plan X", the Volcker-drafted confidential "Paper Prepared in the Department of the Treasury", Washington 31 July 1972 (Duncombe, *Foreign economic policy*, 646-48).

¹²⁹ Sloan, "Groping towards a macrotheme", 277

initially retained all Nixon's appointees and the government structures through which they worked, but soon introduced changes.

Ford revived Cabinet government by reining in the powers of his White House staff and delegating more responsibilities and authority to members of the Cabinet. Observing a vacuum where economic policymaking ought to take place, Ford replaced the redundant Cabinet Committee for Economic Policy with a new Economic Policy Board (EPB).¹³⁰ He claimed the EPB was his "most important institutional innovation".¹³¹ It met at 8.30 am four times a week. Treasury Secretary Simon chaired it; White House aide William Seidman was its Executive Director; Ford attended at least once a week.

The EPB provided a forum in which to discuss economic issues, including international monetary policy. It was large, attended by around 25 people including six of Cabinet rank, making it a better place to air issues than design policy.¹³² So economic policy continued to be prepared mainly in the Quadriad comprising, as under Nixon, the Federal Reserve chairman (Arthur Burns), Treasury Secretary (Bill Simon), CEA chairman (Alan Greenspan) and OMB Director (initially Roy Ash, soon replaced by the capable James Lynn).¹³³ Simon claimed Ford consulted the Quadriad closely.¹³⁴ Neither Ash nor Lynn influenced international monetary policy; both were fully occupied by Ford's domestic budgetary challenges.¹³⁵

Ford expected his fresh approach would improve government effectiveness and transparency. However, as Kissinger noted wryly, "transparency did not guarantee harmony."¹³⁶ As ever, the White House staff and the Cabinet were riven by rivalries; some were not only disruptive, but bitter

¹³⁰ Created by Executive Order on 30 September 1974 (Greene, *Presidency of Gerald R. Ford*, 69).

¹³¹ Mieczkowski, *Gerald Ford*, 119

¹³² Greenspan's views on the respective roles of the EPB and Quadriad are found in Greenspan, *Age of turbulence*, 66-67.

¹³³ Cannon describes Lynn as diligent and possessing considerable analytical ability, "...one of the best budget directors in history" (Cannon, *An honourable life*, 261

¹³⁴ Simon and Caher, *A time for reflection*, 128

¹³⁵ The budget was relatively neglected under Nixon, especially when Watergate began to take its toll on his administration. The budgetary process gained new importance under Ford. He stated "A President controls his administration through the budget. The document reflects his basic priorities... Nixon was bored by the whole process" (Ford, *A time to heal*, 352).

¹³⁶ Kissinger, *Years of renewal*, 172

enough to be described by Kissinger as “hatreds”.¹³⁷ Ford, his patience exhausted, eventually gripped the problem in his “Halloween Massacre” in 1975. Explaining “I was sick and tired of their irreconcilable views”, Ford sacked his Defence Secretary and Vice President, moved his combative and divisive chief of staff out of the firing line and demoted Kissinger, stripping him of his National Security Adviser role.¹³⁸ Whether this brutal action did the trick or the imminent presidential election campaign focussed minds, Ford’s administration thereafter curbed its in-fighting and began to pull together.

Ford Administration: Foreign Economic Policy Executive Personnel

The Foreign Economic Policy Executive’s personnel changed under Ford despite him initially retaining all Nixon’s appointees and Burns being immovable at the Federal Reserve. Simon and Greenspan, Nixon’s final appointee, grew into their roles as Treasury Secretary and chairman of the Council of Economic Advisers, respectively.¹³⁹ Ford’s budget directors, Roy Ash and later James Lynn, focussed on domestic issues. The Foreign Economic Policy Executive under Ford therefore consisted of Ford, Simon, Kissinger, Greenspan and

¹³⁷ Kissinger describes the main feuds as: between himself and Defence Secretary Schlesinger; between Simon and White House chief of staff Rumsfeld; and between Vice President Nelson Rockefeller, a Republican liberal, and Simon, a bone-dry conservative (Ibid., 176). In his memoirs, Simon revealed something of the animosities built up during the Ford administration’s in-fighting when he described Vice President Nelson Rockefeller as “a classic duplicitous politician” (Simon and Caher, *A time for reflection*, 142).

¹³⁸ Quoted in Brinkley, Gerald R. Ford, 129. Volcker’s replacement as Treasury Undersecretary for Monetary Affairs, Jack Bennett, also departed in Ford’s rolling purge of his administration. Bennett, who had been Volcker’s deputy until his promotion into Volcker’s position at the Treasury, had been one of Washington’s most consistent, ideological advocates of floating exchange rates. His enthusiasm for floating exchange rates was not diminished when he left office: one of his first acts on leaving the Ford administration was to publish an article in praise of floating the dollar, “A Free Dollar Makes Sense” in 1975.

¹³⁹ Greenspan tells how Stein, the departing chairman of the CEA, selected Greenspan as his replacement (Greenspan, *Age of turbulence*, 61-64). Simon and Burns persuaded a reluctant Greenspan it was his duty to take the job on the grounds that although Watergate had “paralysed” the administration, the US still needed a well-designed and executed economic policy. Congress approved Greenspan’s appointment to the Nixon administration on 8 August. That evening Nixon announced his resignation. Thus Greenspan’s first day in the job was as a member of the Ford administration. Economists William Fellner and Gary Seevers were his colleagues on the Council of Economic Advisers.

Burns.¹⁴⁰ Simon and Greenspan's arrival markedly strengthened the Executive's pro-market ideology.¹⁴¹

Gerald Ford

Ford was an ambitious politician. Unlike Nixon, Ford never targeted the presidency: his aim was to become the Majority Leader and Speaker of the House of Representatives. He was elected to the House in 1948 and remained a Congressman until Nixon selected him as Vice President.¹⁴²

Ford's ambition shaped his career. A politician seeking the presidency must have a vision of the society he wants to create and the policies he wishes to introduce to deliver his vision, as well as an ideological framework for his policies. This "offer" must be well-publicised and attract voters. A politician seeking leadership within the party must adopt a different strategy. He must avoid any damaging ideological entanglements or policy commitments that may

¹⁴⁰ Ford claimed his "economic team" consisted of Simon, Burns, Greenspan, Ash and Seidman (Mieczkowski, Gerald Ford, 112). The latter, however, appears to have had a mainly administrative role and, judging from the US archives, appeared to have had little or no influence over foreign economic policy. William Seidman was an old friend of Ford's. Like Ford, he came from Grand Rapids, where he became rich co-managing an international accountancy firm (Brinkley, Gerald R. Ford, 78). Ford regarded Seidman as having established a good record of "getting things done", having a good grasp of economics and being "politically savvy" (Cannon, Gerald R. Ford, 261). Ford recruited him to Washington to run his Vice President's office, where Seidman impressed with his administrative skills (Brinkley, Gerald R. Ford, 352). On becoming president, Ford appointed Seidman to be the Executive Director (i.e. committee secretary) of his new Economic Policy Board. Ford relied on the "politically pragmatic" Seidman (and Greenspan) to help design the compromises necessary to win Congress' support for his economic initiatives (Sloan, Groping towards a macrotheme, 282).

¹⁴¹ The ideological shift affected both domestic and international economic policy. Odell (1979, and 1982) argued the ideological shift was one of the main causes of the US adopting floating (see Odell's "Emergence of flexible exchange rates" and his *US international monetary policy*). Whereas Shultz, Volcker and Burns had implemented policies embodying controls and considerable government intervention at the microeconomic level - including wage and price controls, energy rationing and control of the exchange rate - the new Treasury team of Simon and Bennett was committed to allowing market forces to work freely. And whereas Stein had disapproved of, but tolerated, Nixon's wage and price controls, Greenspan warned on his appointment to the CEA he would resign if such policies were reintroduced (Greenspan, Age of turbulence, 63). This change of outlook was not simply ideological; it also reflected dissatisfaction with the outcomes of government intervention. The Nixon administration's experience of micromanagement and market intervention - for labour, goods and services, energy and foreign exchange - had been frustrating. Nixon later described his wage and price controls as "wrong" (Nixon, Memoirs, 521). Simon's experience of administering quantitative controls as the US' "energy czar" had raised his political profile, but had also convinced him government-imposed quantitative controls were always a mistake (Simon and Caher, A time for reflection, p100).

¹⁴² Congress confirmed the appointment on 6 December 1973.

offend or alienate those whose support he might need in future; and he must always pursue a middle path between his party's competing factions, enabling him to reach out to any faction to unify his party. Much of his manoeuvring will be behind the scenes: the public will have little awareness of his role.

Ford pursued his party leadership strategy to perfection: invariably loyal to the Party line; perpetually building compromises; and achieving conciliation within his party and with Democrats. He was anything but a conviction or ideologically-driven politician. Brinkley described Ford as epitomising "lowest common denominator politics".¹⁴³ And it worked, up to a point. He was elected chairman of the House Republican Conference in 1963 (the third highest office in the Republican Congressional hierarchy) and elected House minority leader in 1965, although he never became Majority Leader and Speaker because his party never won a majority during his Congressional career. Ford's reputation for honesty and compromise ultimately worked to his advantage when Nixon needed a replacement for the disgraced Vice President Agnew. Ford was the least objectionable alternative in both the Republican and Democratic Parties' eyes: the lowest common denominator.

Ford had his own opinions, of course. He was part of the foreign policy "Cold War inertia" Nixon attempted to dispel in 1972.¹⁴⁴ Ford held traditional conservative views on economic policy. Having seen Johnson's Great Society programme founder, Ford was sceptical of the value of government interventions. Ford had pulled himself up with his own bootstraps and believed a free market economy and democratic society would give others the same chance. He wanted to foster private enterprise by keeping government small, regulation limited and taxes low: markets, not government, should allocate resources and reward effort. But no ideological belief, except in honesty and straight-dealing, was an absolute for Ford: his goal was policy agreement, through compromise when necessary; its substance was always a secondary consideration.¹⁴⁵ As president he tackled international monetary reform with an open mind: he favoured an international agreement that would unify the US and its allies; he was less committed to basing reform on market principles.

¹⁴³ Brinkley, Gerald R. Ford, 58

¹⁴⁴ *Ibid.*, 28

¹⁴⁵ Ford said of his consensus-building methods: "When I became President I found that our friends were apprehensive about the reliability of the United States as a partner. I set out to reassure them through bilateral and multilateral meetings." (Mieczkowski, Gerald Ford, 300)

Ford's background and his methods of work - steady, dependable, cautious, moderate and conciliatory - ultimately propelled him to the presidency. But they also ingrained in him a manager's habits and outlook, not a leader's. This dogged his presidency. His first test was what to do about Nixon. Seeking to manage the problem rather than provide leadership on it, Ford quickly gave Nixon a full pardon in the hope the nation would put Watergate behind it and move forward under his presidency. But Ford had failed to appreciate the public, underprepared for the pardon, was more vindictive than he, and not ready to move on as he wished. Its opposition to the pardon coloured its view of his presidency. Having had the misfortune to inherit crises in both the US' political and economic systems, Ford now found himself constantly on the back foot, managing the crises through fire-fighting, never leading.¹⁴⁶

The public's criticisms of Ford emboldened Congressional opposition to what he was trying to achieve on economic policy. Economics was a strong suit for Ford.¹⁴⁷ He prioritised cutting inflation from the 12% rate he had inherited from Nixon by curbing government spending and the budget deficit. Congress, however, prioritised tackling the recession and rising unemployment caused by OPEC's oil shock in late 1973. It wanted to boost public spending and cut taxes. Ford could not carry Congress, but Burns atoned somewhat for his Nixon-period profligacy by tightening monetary policy in support of Ford's objectives. Inflation was halved to 6% in time for the 1976 presidential election.

Ford's economic team: Simon and Greenspan

Ford's administration fielded a strong economic team in Simon and Greenspan. Both played prominent roles in the Foreign Economic Policy Executive, both arriving in government from Wall Street.¹⁴⁸ They shared Ford's

¹⁴⁶ DeFrank and Ford, *Write it when I'm gone*, 45

¹⁴⁷ Cannon assessed "No president in modern times had a better understanding of economics" (Cannon, *Gerald R. Ford*, 449). McCracken, the former chairman of the CEA, commented that Ford, unlike Nixon, found economic policy "intellectually stimulating" (Mieczkowski, *Gerald Ford*, 118). This expertise stemmed in part from his work on the House Appropriations Committee, to which he was appointed in 1950.

¹⁴⁸ Simon was recruited as a Treasury Deputy Secretary responsible for policy towards financial institutions. He took up his appointment on 6 December 1972. However, his role as Oil Policy Committee chairman, not international monetary affairs, absorbed most of his time in 1973. He became known as Nixon's "energy czar" after he ensured various mandatory

belief in small government, low taxes and limited economic regulation. Their ideology was determinedly pro-market, more so than was the case for any member of the Foreign Economic Policy Executive under Nixon, except Shultz. Greenspan described himself as a “libertarian Republican”; Simon was regarded as “a truly doctrinaire conservative” and “an evangelist for laissez faire”.¹⁴⁹ British Chancellor Dennis Healey assessed Simon was “far to the right of Genghis Khan and totally devoted to the freedom of financial markets.”¹⁵⁰

Simon and Greenspan accepted Friedman’s views on monetary economics. They had a deep-rooted faith in markets, including foreign exchange markets.¹⁵¹ Burns might continue to oppose flexible exchange rates from his Federal Reserve eyrie, but Simon and Greenspan had no ideological or practical objection to the US operating in a world of floating exchange rates and free capital mobility.¹⁵² Simon and Greenspan, unlike Burns, Connally, McCracken, Shultz and Volcker, believed market-based solutions were always pragmatic solutions. Shultz and McCracken had sacrificed their pro-market principles to support Nixon policies, whereas Greenspan made it a precondition for accepting chairmanship of the Council of Economic Advisers that he would not do so.¹⁵³ This conviction, in conjunction with Ford’s belief in markets, was a major ideological shift in the Foreign Economic Policy Executive.¹⁵⁴

production, transport and trade controls were scrapped in an effort to improve the US’ dysfunctional domestic energy market. Simon was appointed director of the Federal Energy Office in late 1973, where his handling of the domestic impacts of the Arab oil boycott of the US and OPEC’s oil price increases further raised his political profile. When Shultz resigned, Nixon appointed Simon as Treasury Secretary; Congress confirmed the appointment on 30 April 1974. Simon was a Solomon Brothers bond trader during 1964-72, where he amassed a personal fortune, typically earning \$3-4 million annually (Simon and Caher 2004, p61). Greenspan and a partner started their own economic consultancy firm, Townsend-Greenspan, in 1953. It specialised in forecasting the business cycle and advising clients of the implications of macroeconomic developments for their businesses (Greenspan, *Age of turbulence*, 45-46)

¹⁴⁹ Greenspan describes himself in these terms three times in his autobiography (Greenspan, *Age of turbulence*, 208, 238 and 496). These perceptions of Simon are recorded in Greene, *Presidency of Gerald R. Ford*, 70 and in Sloan, *Groping towards a macrotheme*, 282.

¹⁵⁰ Healey, *Time of my life*, 419

¹⁵¹ Simon’s pro-market views surfaced when discussing Britain’s balance of payments problems in 1976. Simon, arguing US balance of payments support should be conditional (against Kissinger’s view that support for an ally should be unconditional), said “‘The market works’, I argued. ‘The market is going to drive the pound down because they (the Labour government) won’t do what they ought to do.’” (Simon and Caher, *A time for reflection*, 153)

¹⁵² Simon refers briefly to the end of the Bretton Woods regime (albeit describing it confusingly as “the gold standard”) in his memoirs: “The gold standard had, certainly by the 1970s and probably much earlier, outlived its usefulness and was neither practical nor sensible in the modern economy.” (Simon and Caher, *A time for reflection*, note 1, 323)

¹⁵³ Greenspan, on being asked to take the CEA role, told Haig (Nixon’s chief of staff) “You’re making a mistake. If I come in as chairman and the administration starts implementing policies I can’t agree with, I’d have to resign” (Greenspan, *Age of turbulence*, 63). This was a

Greenspan, the “rising star”, arguably had a greater influence on Ford than Simon.¹⁵⁵ He provided a theoretical basis for economic policy - no mean feat when macroeconomic theory was in such flux – and helped Ford fashion market-based compromises aimed at making his policy proposals acceptable to Congress and the different factions feuding within Ford’s administration.¹⁵⁶

Simon was effective in a different way. He could not help Ford design policy compromises: he did not seek them.¹⁵⁷ On the contrary, Simon was the administration’s “pugnacious” bruiser who ensured Ford’s economic policy choices were implemented.¹⁵⁸ Kissinger remembered Simon “relished playing the bad cop role”.¹⁵⁹ Ford valued this. He designated Simon his lead spokesman on economic affairs and even considered inviting him to be his running mate in the 1976 presidential elections, an opportunity Simon turned down, preferring to return to Wall Street.¹⁶⁰ After two years under the emollient Shultz, the US Treasury was once again in the hands of a Treasury Secretary who, like Connally, relished confrontation and was determined to win all battles.

Conclusions

The Foreign Economic Policy Executive was never a formally constituted body. It never had a set meeting place or time. There was no dedicated secretariat to prepare its agenda, take its minutes and support it. Yet it existed, however informally, when its members discussed foreign economic policy.

reference to the possibility of Nixon resurrecting price and income controls to appease Congress, which was believed in 1974 to favour the re-imposition of controls.

¹⁵⁴ Odell draws attention to this change of ideological outlook, which he regarded as a contributory factor to the end of the fixed exchange rate regime in the international monetary order (see Odell’s “Emergence of flexible exchange rates” and *US international monetary policy*)

¹⁵⁵ Rumsfeld advised Ford to heed Greenspan’s advice, helping Greenspan increase his influence over the president’s choice of economic policies over time (Crain, *The Ford presidency*, 41).

¹⁵⁶ Sloan, *Groping towards a macrotheme*, 282, and Greene, *Presidency of Gerald R. Ford*, 70

¹⁵⁷ Greene observed Simon was “never willing to compromise” (*Ibid.*, 70). Healey qualifies this statement to some extent, describing Simon as “always fair and sometimes flexible” (Healey, *Time of my life*, 419).

¹⁵⁸ Kissinger’s description in Kissinger, *Years of renewal*, 676

¹⁵⁹ *Ibid.*, 674

¹⁶⁰ Mieczkowski, *Gerald Ford*, 140

The Foreign Economic Policy Executive's economic and political ideology changed over time. Economic ideology gradually shifted from supporting a monetary order based on fixed exchange rates and limited capital mobility, to one favouring floating exchange rates and full capital mobility. Keynesianism and controls represented failure; monetarism and the magic of market forces became the new orthodoxy. This revolution in thinking ensured the Bretton Woods regime designed by White and Keynes in 1944 could not be restored once Nixon had suspended it in August 1971. The Foreign Economic Policy Executive's attitudes toward US political leadership also shifted. Nixon inherited a tradition of Washington delivering leadership through consensual hegemony. He sustained this until opting for leadership through domination in 1971. Finding this less fruitful than Nixon and Connally had expected, Shultz revived consensual hegemony, an approach Ford instinctively welcomed after a career spent promoting compromise in Congress.

The context for US hegemonic strategy changed during 1969-76. Cumulative changes in post-1945 international structures, as well as Watergate's impact on US political legitimacy, had a debilitating effect on US power. The US remained the West's predominant power and hegemon, and it retained sufficient negative structural power to block unwelcome structural initiatives others might propose. But the US' ability to impose its wishes by deploying positive structural power, already precarious when Nixon took office, had weakened further by the time Ford succeeded him. US leadership through domination, a tactic available to Nixon, was no longer available to Ford. Any solution to international monetary problems had to be mutually acceptable to the members of the international monetary order to be viable. Constructivism had trumped realism: US monetary hegemony had become possible only by establishing a willing consensus among allies.

Most of the Foreign Economic Policy Executive personnel changed during 1969-76. Burns and Kissinger were exceptions, representing continuity. McCracken, Connally, Shultz, and Volcker wrestled the monetary issues for varying lengths of time before resigning their posts. Nixon's method of departure was unique. Replacements Ford, Greenspan and Simon outlasted the international monetary crisis, albeit by one year only.

Sterling-Folker claimed all members of Nixon's and Ford's Foreign Economic Policy Executives' first objective was to achieve their president's re-election.¹⁶¹ This was true probably only of Connally: he, untroubled by strong beliefs in political or economic ideologies, offered Nixon political loyalty, even after resigning. Other members of the Foreign Economic Policy Executive were not Nixon or Ford acolytes and cronies. Despite being appointed by a president, they were not all the president's men. They had accepted public office for their own reasons. They had their own political agenda and distinctive ideologies to guide them as they wrestled with the problem of mediating international structural pressures through the prism of domestic politics to produce a coherent foreign economic policy.

The individuality and agency of members of the Foreign Economic Policy Executive mattered increasingly as the international monetary crisis wore on. Nixon's initially attempted to centralise power in the Oval Office and his immediate White House staff. Watergate wrecked that, diverting the president's attention and progressively paralysing his administration during 1973-74. Centralised approaches to policy formulation, co-ordination and implementation simply broke down. Power leached from the Oval Office to cabinet members and individual White House staff. The responsibilities of, and pressure on individual policymakers grew.¹⁶² What they said and did mattered to US policy because Nixon was often distracted. Decentralisation of power happened by accident under Nixon; Ford deliberately pursued it, handing power and responsibility to his Cabinet. The consequences for US hegemony and the international monetary crisis of 1969-76 are explored in the following chapters.

¹⁶¹ Sterling-Folker, *Theories of international co-operation*, 27

¹⁶² Simon credits Haig, Haldeman's successor as Nixon's chief of staff, with painting a vivid picture of the unique challenges Watergate created for the Nixon administration. After noting that some 90 senior vacancies – including top appointees, agency heads and cabinet members – appeared after Ehrlichman and Haldeman resigned, Haig observed: "The government was virtually at a halt. It was being run by unconfirmed professionals and it wasn't being run well because in general technocrats were afraid to take risks... At the same time, risks were terribly high for any official in the administration, dangerously high. Your name, your reputation, your family, and maybe even your freedom were in jeopardy. The opposition was out to jail everybody." (Simon and Caher, *A time for reflection*, 102)

Chapter 4

The Bretton Woods Regime's Demise

“Foreigners are out to screw us. Our job is to screw them first.”

(Treasury Secretary John Connally¹)

This chapter addresses my research question directly, using archived materials to examine how the US attempted to exploit a monetary crisis – a run on the dollar – to strengthen US power and hegemony. I highlight the Foreign Economic Policy Executive's efforts to design a foreign economic policy aimed at mediating between international imperatives and domestic political pressures. I draw heavily on the concepts developed in chapter 1, my definition of hegemony and the neoclassical realist theoretical framework selected in chapter 2, and archived evidence of the policy contributions of individuals in the Foreign Economic Policy Executive as I defined its composition in chapter 3. The chapter provides information relevant to both my research question and the theoretical controversy discussed in my literature review: was the 1969-76 international monetary crisis the result of US hegemonic weakness or strength? The analytical tools developed in chapters 1-3 enables me to explain three dramatic shifts in US foreign economic policy: from a liberal to mercantilist trade policy; from a sound monetary policy supportive of the Bretton Woods regime to an expansionary monetary policy that brought crisis to the regime; and from hegemony by consensus tactics to attempted domination of allies.

Archived materials help identify when and for what reasons the Foreign Economic Policy Executive changed its initial decision to prioritise international imperatives in favour of prioritising domestic political objectives. The Foreign Economic Policy Executive took office in 1969 accepting the need to maintain order in the international monetary system by running a “sound”, low-inflation, domestic monetary policy consistent with the US' obligations to the Bretton Woods regime, and addressing the regime's weaknesses through reforms

¹ Connally, quoted in Nau, *Myth of America's decline*, 162.

based on international agreement and consensus. Attitudes, changed, however, in response to: a US recession increasing unemployment; the Republican Party's inability to achieve the gains it needed to take Congress in the 1970 mid-term elections; and personnel changes within the Foreign Economic Policy Executive. Nixon prioritised a domestic political objective - his victory in the 1972 presidential election – and the Foreign Economic Policy Executive realigned its priorities accordingly. When Nixon demanded his re-shaped economic team deliver an economic boom in time for the election, foreign economic policy was harnessed to this end and tasked with delivering increased US jobs and living standards, and a more powerful US.

The Foreign Economic Policy Executive ceased pursuing consensual international monetary reform and hegemony by consent in 1971 in favour of a mercantilist economic policy and hegemony by domination. The intention was to wring trade policy, exchange rate and defence burden-sharing concessions from unwilling allies, boosting US economic power and hegemony at their expense. The Federal Reserve had by then adopted an extravagantly expansionary domestic monetary policy, boosting the money supply by one quarter in a mere two years, heedless of the US' Bretton Woods obligations to deliver "sound money".² This provoked two runs on the dollar in 1971. Nixon used the second as a pretext for imposing a large surcharge (tariff) on US imports and suspending gold convertibility, thus temporarily preventing the Bretton Woods regime from functioning. Nixon wanted to use the crisis to change other states' behaviour in the international monetary system; his intention was to strengthen the US' prosperity, relative power and hegemony.

The chapter is organised as follows: it outlines Bretton Woods' main problems; discusses initial US attempts at international monetary reform; US monetary expansion and neomercantilism; and the Bretton Woods regime's consequent demise. A final section draws conclusions.

² The US' obligation to ensure international monetary stability was one of the Bretton Woods regime's unwritten norms. Volcker touched on the US' obligations: "One of those was a special responsibility for maintaining a sound currency on which others could depend. Can any fixed-rate system operate without a dominant world power ready to provide responsible leadership and to maintain discipline? ...that was the role the United States played reasonably well for more than twenty years." (Volcker and Gyohten, *Changing fortunes*, 63)

Bretton Woods Regime Problems

The gold pool's collapse in 1968 and the subsequent creation of a two-tier gold market signalled the onset of a terminal crisis in the Bretton Woods regime.³ By 1969 it was clear the regime's difficulties stemmed from two fundamental problems: the post-war world had not evolved as its designers had expected; and the regime was blighted by design flaws.⁴

Flawed assumptions

White and Keynes had to make assumptions about the world economy's future when they negotiated the Bretton Woods regime's blueprint.⁵ Two crucial assumptions were wrong, affecting the regime's liquidity-creation and adjustment mechanisms.

Liquidity creation. Central banks needed gold and foreign exchange reserves to defend their fixed exchange rates. Gold production was expected to keep pace with global economic growth. It did not. International trade grew much faster.⁶ Consequently the world's stock of monetary gold fell from 61% of the value of world exports in 1950 to 17% in 1969, creating a profound liquidity

³ The gold pool was a cartel formed by eight major industrial country central banks in 1961 with the aim of stabilising prices in the gold market at the official price used in the Bretton Woods system, \$35 per fine ounce. When the gold pool's operations became unsustainably expensive in 1968, the cartel collapsed and most governments segmented the market for gold between official and private sector transactions. Private sector gold trades were permitted to take place at whatever the (variable) market price happened to be; official transactions (i.e. those involving governments and central banks) would take place at the fixed \$35 official price. Most central banks in industrial countries, but not the Banque de France, agreed not to buy or sell gold on the private market, or to trade gold at market prices.

⁴ A comprehensive account of the Bretton Woods regime's problems may be found at Williamson, *Failure of world monetary reform*, 1-52.

⁵ Conway, *The Summit*, Gardner, *Sterling-Dollar diplomacy*, and Steil, *Battle of Bretton Woods*, present blow-by-blow accounts of the US-UK negotiations lead up to the Bretton Woods agreement in 1944; Harrod, *Life of John Maynard Keynes*, and Skidelsky, *John Maynard Keynes*, provide accounts of these events from Keynes' perspective.

⁶ The world's stock of monetary gold increased, but by less than one per cent per annum on average during 1950-69. A secret report, *The United States' Position in the World*, prepared by consultants (probably led by Professor Richard N. Cooper) for the Department of Defence, State Department and CIA and forwarded to Kissinger at the National Security Council on 20 August 1969, warned the Nixon administration the gold shortage was likely to continue (Duncombe, *Foreign economic policy*, 66-72).

strain on the Bretton Woods system.⁷ Central banks were forced to increase the proportion of foreign exchange in their reserves. There were problems here too. Sterling never recovered its earlier importance as a reserve currency. The world economy became dependent on the US dollar to meet its growing liquidity needs. The Federal Reserve became a near-monopolist over the supply of additional world reserves, and eventually abused its position, running an inflationary monetary policy during Johnson's presidency.⁸ This undermined the purchasing power of central banks' dollar reserves, creating frictions: European politicians in particular resented paying for the Vietnam War.

Adjustment. The Bretton Woods regime's design assumed minimal international capital flows, although its rules did not require this.⁹ Capital flowed abroad from the outset and the stock of offshore capital built quickly. The Eurodollar market, a home for the private sector's offshore liquid capital, was estimated to be worth \$44 bn. in 1969.¹⁰ This dwarfed individual G10 states'

⁷ According to data in the IMF's *International Financial Statistics Yearbook, 1980* the global stock of monetary gold held by central banks rose from 952 million fine ounces in 1950 to 1,112 million fine ounces in 1969. There was no change in the official price of monetary gold in this period: it remained at \$35 per fine ounce throughout. The volume and value of global monetary gold stocks therefore increased by a total of 16.8% between 1950 and 1969; in the same period the volume of world trade grew by approximately 300% and its value increased by 331%.

The need to tackle the regime's liquidity problems led to various patches being introduced in the 1960s, including the General Agreement to Borrow, ad hoc foreign currency swap arrangements between central banks, creation of a new reserve asset, the Special Drawing Right, agreed in principle in 1968, and the gold pool.

⁸ The Bank of England's archives contain estimates of changes in global official reserves during 1949-1970. The estimated total increase in official reserves was \$59.3 billion, of which only \$3 billion was due to increases in gold reserves; reserves held in sterling *fell* by \$0.1 billion; reserves held in dollars increased by more than \$45 billion (Bank of England file OV53/42 December 1971).

⁹ Keynes and White wanted short-term capital flows to be suppressed under Bretton Woods. Early attempts to make capital control mandatory in the Bretton Woods regime's rules were watered down at US insistence, however, to the point where capital controls were permitted, not required of member states. The US Treasury wanted to be able to attract capital flows from abroad to help it fund US government debt. The Departments of State and Commerce were keen to permit international capital flows to facilitate US overseas aid and foreign direct investment abroad. Wall Street banks wanted the freedom to expand internationally. The early influence of US domestic economic interest groups on US official attitudes to capital controls and the Bretton Woods regime's design is evident here. (See de Cecco, "International financial markets", 382-384.)

¹⁰ This figure, estimated by the BIS, is net of cross-deposits: see Calleo and Strange, "Money and world politics", 96. Webb, citing the same \$44 bn. estimate of net deposits, observes the Eurodollar market's assets were larger than this because it had issued \$5.3 bn. of bonds (Webb, *Political economy of policy co-ordination*, 98). Further private sector liquid capital was held abroad in the smaller markets dedicated to other currencies, the Eurofranc, Euromark and Eurosterling etc. BIS and IMF published different estimates of Eurodollar market size. The BIS' estimates tend to be higher than those reported by the US authorities to the IMF and published in the IMF's *International Financial Statistics*. The discrepancy is presumably explained by tax-avoiding capital flight from the US (which distort US data) as well as legitimate

foreign exchange reserves: markets could outgun any central bank (Table 4.1). No central bank could resist speculative exchange rate attacks for long. Safe haven states (such as Switzerland), or states thought likely to appreciate their currency (the FRG), risked unwelcome capital inflows boosting their money supplies - and their inflation rates.

Table 4.1 Ratio of central banks' total reserves to total Eurodollar market deposits, 1969 (in per cent)¹¹		
	<i>Total reserves</i>	<i>Foreign exchange reserves</i>
Canada	11	7
FRG	31	19
France	11	3
Italy	12	5
Japan	11	7
UK	6	3
US	33	1
G7 states' total reserves	115	45

Powerful international financial markets were not part of Bretton Woods' design. Its leisurely adjustment procedures were intended to cope with trade and current account imbalances, not fast-moving capital flows requiring policy adjustments within days, not weeks.¹² It became untenable for the IMF to give

dollar-denominated offshore transactions between non-US banks that were reported to the BIS but are (legitimately) not captured in the Federal Reserve's reporting system. Both the IMF and BIS present data on US net liabilities to the Eurodollar market, i.e. their statisticians attempt to avoid double counting dollars that are deposited in one Eurodollar account before being on-lent and deposited in another Eurodollar account. Differences in IMF and BIS "netting off" methodologies may also explain some of the discrepancies in the two organisations' estimates of the Eurodollar market's size.

¹¹ Sources: Total reserves data from IMF *International Financial Statistics Yearbook, 1980*; Eurodollar market net deposits are estimated in Calleo and Strange, "Money and world politics", 96. "Total reserves" comprise a central bank's gold, foreign exchange and its net asset position at the IMF.

¹² The Bretton Woods regime required a member state to obtain the IMF's authorisation before devaluing or revaluing its exchange rate in response to balance of payment disequilibrium. IMF authorisation could be given only where there was evidence of "fundamental" disequilibrium. This requirement was intended to prevent states implementing competitive devaluations and repeating the "beggar-thy-neighbours" currency policies of the 1930s. Fundamental disequilibrium (or not) would be established by the IMF sending a team of economists to the member state concerned on an "Article IV programme mission" to assess the

itself three weeks to ponder a decision on whether a member state's economy was in "fundamental imbalance".¹³

Flawed design

Global dependence on the dollar for liquidity became problematic after 1958, when European states made their currencies freely convertible and the US changed from being a net official creditor to a net debtor. Triffin spotted the design flaw: a growing world economy required additional liquidity; that meant more dollars; but the US could only feed dollars into the world economy by running balance of payments deficits, adding to its debts and the gap between its gold assets and its official liabilities.¹⁴ The dollar could function as a reserve asset for central banks alongside gold only if it were accepted as being "as good as gold". Avoiding a run on US gold reserves depended on confidence in gold convertibility, but the growing gap between US gold assets and dollar liabilities undermined confidence.

The situation was perilous when Nixon took office: US gold reserves had fallen to \$10.9 billion; US external official liabilities had risen to \$38.5 billion (chart 4.1).¹⁵ The US depended on foreign central banks not exercising their right, *en masse*, to convert their dollar reserves to gold.¹⁶

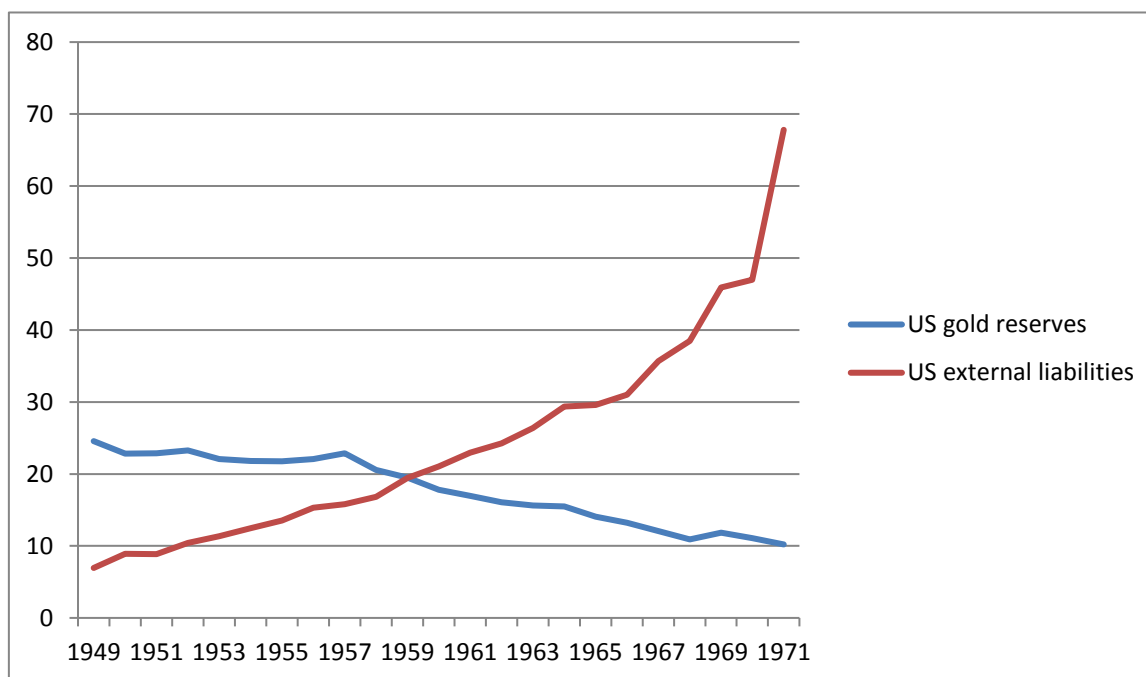
situation. The mission might last two to three weeks, after which the team would return to Washington, write its report and recommendations and circulate them to the Executive Board for consideration. IMF procedures required member states be given 3 weeks to study the IMF staff's recommendations before voting on them. Short cuts in this process might be possible, but a decision would nonetheless take at least a month. Central banks, however, tended to close foreign exchange markets within days of the start of a speculative attack on a currency.

¹³ The French and FRG exchange rate changes in autumn 1969 are illustrative of these pressures. For those who believe in the international power of regimes, it was striking that neither France nor the FRG acted within the IMF's rules; both changed their parity values unilaterally in August and October 1969, respectively, without seeking the IMF's prior approval. Others noticed their failure to follow the rules. Harold Wilson, bruised by the UK's experience of devaluation in 1967, sourly drew attention to the French approach in his memoirs, commenting "The French devaluation (of 8 August) had been well-planned and carried through in secrecy. There had been no prior speculation or drain on the reserves. The franc was, of course, not an international currency; and in any event, it is always easy for those to affect surprise who decide not to comply with the international rules governing these matters. The International Monetary Fund had not been given the necessary notice" (Wilson, Labour government, 691).

¹⁴ Triffin first warned of creditor states losing confidence in the US ability to convert their dollars to gold in 1960. He repeated his warning throughout the decade: see, for example, Triffin, *Evolution of the international monetary system*, for a clear statement of his concerns.

¹⁵ These data were reported by the US to the IMF and published in the IMF's *International Financial Statistics Yearbook* (1979). The Treasury was unsure where the limit

Chart 4.1 US gold reserves and external official liabilities, 1949-71 (\$ bn)¹⁷



The Bretton Woods regime's adjustment and liquidity-creation mechanisms were at odds with each other. Global economic expansion required additional dollar liquidity. Liquidity creation depended on the US running balance of payments deficits and not adjusting. But adjustment was required to sustain creditors' confidence in the dollar being "as good as gold".

The US responded to this conundrum by adopting a "benign neglect" policy.¹⁸ It left the liquidity-creation decision to the collective will of all other

should be placed on the decline in US gold reserves. In his Confidential Memorandum from Treasury Secretary, Kennedy, to President Nixon, 23 June 1969, Kennedy asked for Nixon's agreement to allow the US gold reserves to fall to \$8 bn to enable the Treasury to deal with the demand for gold from "nibbling" central banks (Duncombe, *Foreign economic policy*, 341-44).

¹⁶ Most central banks holding dollar reserves voluntarily refrained from converting their dollars to gold for fear of triggering a run on US gold reserves and the consequent damage to the Bretton Woods regime. The FRG agreed to formalise this policy as part of the defence offset (i.e. burden-sharing) agreement with the US in 1967. General de Gaulle, however, took the opposite tack for a time, adding to US gold vulnerabilities by requiring the Banque de France to convert into gold at least 20% of its dollar receipts. This French "gold war" ceased when France moved into balance of payments deficit in 1968.

¹⁷ Source: IMF *International Financial Statistics Yearbook*, 1979

¹⁸ This was known as "benign neglect" because the policy required the US not to set a current account balance target. In any economic system of "n" number of states, the system will be stable if no more than n-1 states are permitted to set and pursue current account targets. The nth state, the US in this case, must be prepared to absorb the collective current account consequences of the n-1 states' decisions. The system would become unstable if the nth state were to pursue a current account target of its own that was incompatible with the collective decision of the n-1 states. If, for example, n-1 states decide they wanted to run current account

states. The US remained passive, allowing its balance of payments to be determined by the impact of the rest of the world's balance of payments policies. Typically, other states collectively chose to accumulate additional dollar reserves, requiring the US to run balance of payments deficits. Washington claimed its policy had been successful initially: US trade surpluses had covered the foreign currency costs of overseas military spending, foreign aid and direct investment during the 1940s and 1950s, but the margin of surplus declined markedly in the 1960s because other states increased their demand for foreign exchange reserves; moreover, the Vietnam War added to US costs while declining US competitiveness shrank its trade surplus (Table 4.2).

	Table 4.2 US Balance of Payments: Selected Indicators, 1966-72 (\$ bn)¹⁹							
	1960-65*	1966	1967	1968	1969	1970	1971	1972
Current account balance	5.3	3.0	2.6	0.6	0.4	2.3	-1.4	-5.8
Trade balance	6.4	3.8	3.8	0.6	0.6	2.6	-2.3	-6.4
Direct defence spending abroad	-3.1	-3.8	-4.4	-4.5	-4.9	-4.9	-4.8	-4.8
US government grants**	-4.0	-3.8	-3.8	-4.3	-4.3	-4.4	-5.6	-6.7
US long-term lending (net)***	-1.3	-1.3	-2.3	-2.3	-2.2	-1.6	-2.1	-1.7

*Annual average. **Includes military as well as development assistance grants.

***Primarily development assistance loans, net of repayments

surpluses, the system would be stable only if the n^{th} state were prepared to run the counterpart deficit. If it too decided to run a current account surplus, the system would become unstable.

¹⁹ Source: US Department of Commerce, Bureau of Economic Analysis: *International transactions, 1960-present* (www.bea.gov/international/)

Washington convinced itself the US was not responsible for balance of payments deficits: US deficits were caused by other states' demand for dollar reserves; if those states wanted the US to run lower deficits, they should make the necessary policy adjustments. Other governments disagreed, grumbling the US ran deficits because Washington chose to exploit the dollar's central role, an "exorbitant privilege". Washington, they contended, used US freedoms from balance of payments constraints to project power through military and foreign aid spending, and by buying other states' industries through foreign direct investments. They believed US deficits were not demand-driven, but supply-driven; adjustment was therefore the US' responsibility.

Placing the onus of adjustment purely on deficit states, with no counterpart obligation on surplus states, was another Bretton Woods design flaw.²⁰ States were free to run surpluses and accumulate unlimited reserves. Other states could run deficits only until reserves depletion forced them to adjust.²¹ Some states, including the FRG, France and Japan, targeted current account surpluses.²² The Bretton Woods regime accommodated this by putting pressure on other states: surpluses must be matched by deficits elsewhere. Deficit states did not accept they alone were the source of payments imbalances and resisted policy adjustments. Moreover, devaluation became

²⁰ This issue divided Keynes and White. Keynes wanted to impose adjustment responsibilities on both deficit and surplus states. White insisted adjustment responsibilities should be mandatory for deficit states only, and voluntary for surplus states. He did so because he expected Europe, Japan and developing countries to run current account deficits as they rebuilt their economies after the Second World War, and the US would run the counterpart surplus. He believed the US should not be penalised for this and claimed Congress would not accept the "tax" Keynes wished to impose on surplus states.

²¹ The standard IMF approach to balance of payments adjustment was to insist on a state adopting a combination of expenditure reducing and expenditure switching measures. Spending reductions would cut imports; devaluation would increase an economy's competitiveness and switch spending, encouraging export sales while reducing spending on imports. If the expenditure reduction and switching measures were sufficiently strong, they would also create confidence in a state's economic policies and reduce the risk of capital flight.

²² These states lost a large proportion of their overseas financial assets after the Second World War. Rebuilding those assets was economically sensible. The FRG and Japan pursued export-led, import-compression growth strategies after 1945. Kriele discusses the German case in "West Germany: the dynamics of expansion". Gray observed that, when put under political pressure to appreciate their currencies to moderate their current account surpluses, their response, typically, was to adopt the argument "Why apply medicine to healthy rather than sick currencies?"; Gray also quotes Alwin Munchmeyer, president of the Federal Association of German Banks, as saying on 12 September 1968 "Why is it our (the FRG's) job to ensure other countries become competitive?" (Gray, "Floating the system", 299) Schmiegelow and Schmiegelow, in "New mercantilism", and Zysman, in "The French State", discuss French neomercantilist policies in this period.

confused with policy failure or speculator-imposed defeats.²³ Consequently devaluation - and adjustment more broadly - became infrequent in the 1960s; tensions inevitably rose.²⁴

The US, running serial deficits, faced the additional complication of the dollar being pegged to gold, while all other currencies were pegged to the dollar. Whereas other states were free to appreciate or depreciate their currencies if they wished (but usually did not), Bretton Woods' rules left the US willing to improve its competitiveness against other currencies by depreciating the dollar, but unable to do so by virtue of Bretton Woods' design.²⁵ The US could only devalue against gold, potentially dragging down all the other currencies pegged to the dollar and creating no competitive gain for the US.²⁶

Bretton Woods' design flaws added political resentments to the economic tensions. US policymakers grumbled about their unique inability to depreciate the dollar to boost US competitiveness. Other states complained of the US' unique role in liquidity-creation: Washington benefited from seigniorage income and, moreover, never faced a balance of payments constraint because the US issued the world's reserve currency.²⁷ Of course US privileges also brought responsibilities. But Europe and Japan complained the US no longer set its monetary policy to ensure the dollar was "as good as gold", adopting instead inflationary monetary policies to fund the Vietnam War.²⁸ Furthermore, there

²³ Coggan observed: "...devaluations were very rare. Governments saw devaluations as national humiliations and strived hard to avoid them" (Coggan, Paper promises, 111).

²⁴ Japan did not alter its yen/dollar exchange rate at all during 1949-71, despite persistent balance of payments surpluses. Germany appreciated its currency on only two occasions (1961 and 1969). The UK devalued twice (1949 and 1967) and France only three times (1957, 1958 and 1969). See McKinnon, "Rules of the game", 13, for a discussion of the adjustment shortcomings the Bretton Woods regime. Gowa, Closing the gold window, 37-38, pointed out that no major state realigned its exchange rate between 1962 and 1967, concluding "the adjustment process had failed".

²⁵ The deterioration in US competitiveness during 1945-70 was debated at length in the economic literature of the time. See Whitman's "Leadership without hegemony", for a comprehensive and balanced discussion. Webb and Krasner, in "Hegemonic stability theory", provide a broad range of quantitative indicators showing the extent to which the rival states caught up with the US during 1945-75.

²⁶ This was not a theoretical scenario. Volcker recalled Hendrick Houthakker, one of the three economists on Nixon's Council of Economic Advisers in 1969, visiting the European Commission to discuss a possible US devaluation. Houthakker asked how European states would respond. A senior Commission official predicted Europeans would respond by protecting their economies' competitiveness: "All European currencies would be devalued by the same percentage on the same day" (Volcker and Gyohten, Changing fortunes, 67)

²⁷ Seigniorage arises because the cost of producing a unit of currency (say the cost of printing a dollar) is almost always less than the purchasing power of that unit of currency.

²⁸ This complaint appeared somewhat exaggerated. US inflation averaged 1.7% per annum during 1960-6, similar to the level in the previous decade (Coggan, Paper promises,

was no agreement on what to do about the US deficits, or even who was responsible for them: were they driven by the rest of the world's demand for additional dollar reserves (Washington's view), or by the US' determination to project its power through unconstrained overseas spending?²⁹

Many states were unhappy with the Bretton Woods regime by 1969. It did not create harmonious co-operation between states. Dissatisfaction was kept in check, however, by fears of monetary instability and a return to the chaotic, unco-operative economic environment of the 1930s. States' inclination to co-operate remained strong, as demonstrated in 1968 when, in a single year, there were international agreements creating both the SDR and the two-tier gold market, and a guarantee for the UK's ever-problematic sterling balances.³⁰ The least co-operative state, France, was weakened by the events of May 1968 and obliged to call off its "gold war" against the US.³¹ These developments provided a fillip to Bretton Woods regime supporters.

110). Nonetheless, when Bundesbank Vice President, Otmar Emminger, shared his thinking with Bank of England officials on 9 January 1969, he criticised the US, warning "(i)t should, however, not be overlooked that a perpetual world inflation, led by the USA, would in all probability bring down our present gold-dollar standard, at least over time." Emminger believed US inflation was being transmitted unevenly to other states, resulting in them needing to adjust their exchange rates constantly to offset the differentials in their inflation rates. But some states were unwilling to do this unless, in his opinion, foreign exchange market speculation created a crisis. Emminger argued stability could be restored only if the US "resumed its former role of standard-bearer for stability", by which he meant cut its budget deficit and adopt a low-inflation monetary policy. (Bank of England archive file OV53/40)

²⁹ The UK Treasury's Bill Ryrie, a middle ranking monetary policy "technician", detected a change in Washington's tone on responsibility for US deficits after Nixon had taken office. Ryrie observed that whereas the Johnson administration had accepted the European position (that the US should deal with its deficits), the Nixon administration was taking a harder line, in effect saying "either help us reduce our deficit or finance it". Ryrie added the US was unlikely to suspend gold convertibility as a deliberate choice, but would do so if they felt it were being forced on them by demands for their gold: "... if they do begin to lose reserves again on a considerable scale, I do not think they would have too much hesitation about taking this step..." (Letter from W Ryrie to J A Kirbyshire, 8 April 1969; Bank of England archive file OV53/40)

³⁰ The principle of creating a new reserve asset, the Special Drawing Right (SDR), had been agreed internationally in 1968. But, at France's insistence, "activating" this agreement by creating and distributing SDRs would require agreement by states holding 85% of quota in the IMF Board. (France insisted on the 85% threshold because Europe held more than 15% of IMF quota and could collectively veto any SDR creation proposals it considered inflationary.)

Britain built up large overseas liabilities during the Second World War, some of which were held by Commonwealth states as part of their foreign exchange reserves, the "sterling balances". These bedevilled UK policy because any large-scale attempt to convert these reserves into another currency would undermine British efforts to maintain sterling's fixed exchange rate. The problem was a British equivalent to US' fears of a run on its gold reserves.

³¹ The Treasury's brief for President Nixon's first official visit to Paris cautioned him "(t)he basic French attitude towards the international monetary system is fundamentally different from ours." The brief warned the French would urge Nixon to devalue the dollar against gold (to stimulate US adjustment as well as provide windfall gains for France's official reserves and for its many private sector gold hoarders) and press him to accept international monetary reforms aimed at imposing "stern discipline" on the US and "severe limitations on the future of the dollar

International monetary issues did not feature in the 1968 presidential election campaign. Nixon arrived in office with a free hand on the matter, having pledged only to abolish the capital controls President Johnson had introduced.³² Aware the Bretton Woods regime had problems, however, Nixon advocated its reform. One of his first acts was to tell Kissinger to instruct Volcker to create and chair a Working Group on international monetary issues. The Working Group, the “Volcker Group” as it became known, was told “to make recommendations on US international monetary policy... and to implement decisions.” Its first task was to produce a report by 15 February that would “consider our policy options with regard to the US balance of payments, the functioning of the international monetary system and contingency plans for response to potential currency crises...”.³³ Nixon also visited the Treasury to give its staff a pep talk and tell them he wanted the US to provide leadership on international monetary reform. He emphasised he was aiming at hegemony through consent, not domination, telling the Treasury staff: “Now is the time to examine the international monetary system to see what its strengths are, where

as a reserve currency” (Confidential “Talking Paper” prepared by the US Treasury for President Nixon, 19 February; Duncombe, *Foreign economic policy*, p305). When Sargent Shriver, US ambassador to France, called on President Pompidou to discuss international monetary issues, Pompidou said he believed gold would provide a better discipline on the US than the SDR; the US could not count on French support for SDR activation until it demonstrated greater self-discipline and cut inflation (Confidential Telegram from the US Embassy in Paris to the State Department, 24 July 1969; Duncombe, *Foreign economic policy* 361-62).

³² The Nixon administration repeatedly discusses whether and when to honour this pledge. The matter was first raised formally in the Cabinet Committee on Economic Policy’s first meeting, on 24 January 1969. Action was delayed by fears that abolishing US capital controls would damage the US balance of payments and annoy allies. See Action Memorandum from Richard Cooper and Fred Bergsten to the President’s Assistant for National Security, Kissinger, 28 January 1969 (Duncombe, *Foreign economic policy*, pp5-6). When the issue was raised again, Federal Reserve chairman Martin warned “a sizeable relaxation of capital restraint programmes can only be seen by close observers as leading to some sort of crisis - presumably a suspension of convertibility of the dollar into gold.” (not classified Letter from the Chairman of the Board of Governors of the Federal Reserve System, Martin, to Treasury Secretary, Kennedy, 21 October 1969; Duncombe, *Foreign economic policy*, 76-78). Shultz argued strongly, repeatedly and at length for lifting capital controls until he was able to announce the policy himself in February 1973. A typical example of Shultz’s thinking on the matter is set out in his not classified Memorandum from the Director of the Office of Management and Budget, Shultz, to members of the Council on International Economic Policy, 2 March 1971 (Duncombe, *Foreign economic policy*, 127-31).

³³ Secret National Security Memorandum 7, signed by Kissinger and sent to Volcker on 21 January 1969 (Duncombe, *Foreign economic policy*, pp290-91). Volcker remembered this as Memorandum “Number Two”, but the State Department’s archived document clearly shows this as “7”, not “2” (Volcker and Gyohten, *Changing fortunes*, 64).

its weaknesses are and to provide the leadership, leadership which is responsible, not dictatorial, leadership which looks to good judgement and the good advice that we can get from our friends abroad who will have a similar view about the necessity of a sound international monetary system.”³⁴

The Treasury adopted a three-pronged strategy in response: Treasury Secretary Kennedy and Volcker met their G10 Finance Ministry counterparts to lobby for early, large SDR activation; middle-ranking officials initiated secret discussions with European G10 members on the technical aspects of achieving greater exchange rate flexibility; and Volcker pushed his Group to refine its initial proposals on international monetary reform, aiming to produce an options paper for the President by June 1969.³⁵ The strategy produced mixed results.

Liquidity: SDR activation and IMF quota increases

An IMF quota increase and SDR activation was agreed internationally relatively quickly, albeit below the amounts the US had hoped to achieve.³⁶

³⁴ Nixon's 14 February 1969 remarks were reported in the State Department's unclassified telegram to the Mission at the OECD, Paris and copied to five other European posts, sent on 19 February 1969 (Duncombe, Foreign economic policy, p308).

³⁵ With gold reserves failing to grow as fast as Bretton Woods regime designers had expected, the SDR was created to make good some of the gold shortfall and take some pressure off the dollar as the only additional reserve asset. The 1968 SDR agreement was on the principle of creating SDRs. Principle could not be put into practice until IMF member states had approved SDR "activation". The IMF SDR "activation" agreement would determine the number of SDRs to be created and the pattern of their distribution to IMF member states. "Activation" thus became the international bureaucrat's term for SDR creation and distribution.

The Volcker Group's first analysis of the international monetary situation was supposed to have been discussed by the National Security Council on 15 February 1969, but the meeting never took place. This rather confirmed Volcker's initial fears that international monetary issues would quickly work their way to the bottom of Kissinger's in-tray, such was the latter's enduring lack of interest in economic matters.

³⁶ The US Treasury lobbied other states to agree to create \$4 bn. of SDRs annually, equivalent to some 4% of global reserves. The US had to compromise to win SDR activation, but got much of what it wanted. G10 Deputies met in Paris in July 1969 and, after what Volcker described as "hard bargaining", agreed, subject to Ministerial approval, the IMF should issue SDR 9.5 bn in tranches of 3.5/3/3 over three years, starting in September 1969. IMF Governors approved this at their annual meeting in September 1969. It was an important success for Volcker and Federal Reserve Board governor Daane, who participated in G10 Deputies meetings alongside Volcker. It represented a higher figure than the Europeans had indicated they wished to accept. Europeans had feared that piling an SDR distribution on top of the additional dollar reserves they expected the US to create through its on-going balance of payments deficits, would be inflationary. The US overcame that fear, in part at least. France, which continued to prefer gold-based to paper-based monetary solutions, initially opposed the agreement, but found itself isolated and withdrew its opposition. This justified Volcker's belief the EEC would not always slavishly follow a French lead on international monetary issues,

Kennedy's and Volcker's lobbying for early, large SDR activation elicited a positive response from Europe, although tempered by concerns for the inflationary consequences of issuing a new reserve asset before the US had tamed its balance of payments deficits. Volcker became the Nixon administration's international monetary diplomat, spending a considerable part of February 1969 visiting his G10 Deputy counterparts in Europe and attending a Working Party 3 (WP3) meeting at the OECD headquarters in Paris. Kennedy hosted meetings with his main G10 counterparts.³⁷ Their lobbying led them to believe G10 states were prepared to agree to the IMF issuing some \$2 bn of SDRs annually for a period of five years.³⁸ Volcker negotiated G10 agreement to \$10 bn over three years at a G10 Deputies meeting in July 1969; it was endorsed by IMF members in September 1969. Although \$10 bn was half the amount Kennedy and Volcker had targeted, they settled for this, hoping a larger sum could be negotiated in due course.

The SDR agreement added \$9.5 bn. to global liquidity over three years. It was soon followed by agreement to increase IMF quotas by 35%, adding a further \$7.6 bn. to international liquidity in 1970.³⁹ Many believed Bretton Woods' liquidity problems had been solved. FCO Economists sent a guidance telegram on the international monetary system to all FCO posts informing them "The mechanisms are in place to handle future requirements for increases in reserves, and adequate increases in liquidity are in prospect for the early 1970s. But the balance of payments adjustment problem remains."⁴⁰

A co-operative approach to solving liquidity problems under US leadership were what Liberal international relations theorists, such as Ikenberry

implying US investments in international co-operation could pay dividends. Volcker reported his success to Kennedy via a confidential telegram from the US Embassy in Paris to the State Department on 25 July 1969 (Duncombe, Foreign economic policy, 363-65).

³⁷ Kennedy met Jenkins, 28 April – 1 May 1969; Giscard d'Estaing, 3-5 May; and Schiller, 3 June. He delayed meetings with his counterparts in the smaller G10 states until he visited Europe in December.

³⁸ Estimate included in Kennedy's Confidential Memorandum from Treasury Secretary, Kennedy, to Nixon of 23 June 1969 (Duncombe, Foreign economic policy, 341).

³⁹ Agreement on a 30% increase in quota was expected to be reached at the IMF's annual meeting in September 1969. In the event agreement was delayed until 24 December 1969. This raised the IMF's quota by \$7.6 bn (a 35% increase) of which the US contributed \$1.54 bn. Kennedy reported this outcome in a confidential memorandum to Nixon on 29 December 1969 (Duncombe, Foreign economic policy, 387-88).

⁴⁰ FCO confidential diplomatic Report No 542/70 "The International Monetary System"; Bank of England file OV/53/41

and Keohane, would have expected.⁴¹ The US had invested heavily in creating the Bretton Woods regime, and advanced its national interests by improving the regime. Other member states supported the US because all benefited from increased liquidity and a functional regime. But this proved to be the high point in the Nixon administration's reliance on international monetary co-operation and consensus when securing US interests.

Adjustment: greater exchange rate flexibility

Co-operation delivered a US success on liquidity issues, but the US' secret G10 consultations on the technicalities of new, more flexible exchange rate mechanisms failed: European states adamantly opposed the principle of greater flexibility. Co-operation had its limits.

The exchange rate flexibility consultations with European G10 states proceeded rapidly, mostly in April 1969, although discussions with the British were not completed until mid-May.⁴² The outcome disappointed Volcker: he did not report his findings to his G10 counterparts until December 1969.

US ambitions had been limited: only certain types of exchange rate flexibility were discussed, such as "gliding" or "moving" pegs, and authorising currencies to move within wider margins around their central (par) rates.⁴³ Freely floating rates were excluded from the US agenda: floating was beyond the pale for officials undertaking serious discussions.⁴⁴ Although some

⁴¹ See chapter 2 above.

⁴² US Treasury officials held secret bilateral talks in London on 25-26 March; Stockholm, Amsterdam, Paris and Rome followed in the week of 21-25 April; then Zurich and Brussels on 29 and 30 April, respectively. The round of bilateral discussions concluded with follow-up discussions with British officials on 13-14 May. German views were sought in the margins of bilateral discussions Kennedy and Volcker held with Schiller and a German team at Camp David on 3 June.

⁴³ The Bretton Woods regime's rules required the US to peg the dollar to gold at an official exchange rate and all other member states to peg their currencies to the dollar at an official exchange rate. The central rate, known as the par value, was fixed, but central banks were allowed some flexibility: exchange rates were permitted to move on a day-to-day basis within a margin of 1% either side of the central value of the official exchange rate.

⁴⁴ Treasury antipathy towards market-determined floating exchange rates, as distinct from more flexible exchange rates, continued until at least May 1971, when Connally told Giscard d'Estaing he "had many discussions with Dr. Burns and the two were in agreement in opposing floating rates." Confidential Memorandum of Conversation between Treasury Secretary, Connally, and French Minister of Economy and Finance, Giscard d'Estaing, 20 May 1971 (Duncombe, Foreign economic policy, 434-37).

academics led by Milton Friedman were advocating floating exchange rates with varying degrees of enthusiasm, Burns accurately summarised official attitudes toward floating rates in a memorandum he sent Nixon on 22 February 1969: “whatever else we may do, let us not develop any romantic ideas about a fluctuating exchange rate: there is too much history that tells us that a fluctuating exchange rate, besides causing a serious shrinkage of trade, is also apt to give rise to international political turmoil.”⁴⁵ Shultz, Friedman’s conduit into administration thinking, believed otherwise. But he was new to the Cabinet and, as Secretary of Labour, was marginal on the issue and in no position to sway the President’s thinking against advice from Burns, the President’s longest-established and most trusted economic adviser.⁴⁶

George Willis, a senior Treasury official, summarised the outcome of the secret international technical consultations in a note circulated to the Volcker Group on 27 May: “Prevailing attitude toward exchange rate flexibility: negative...”⁴⁷ The Europeans objected because this would “weaken disciplinary processes on deficit countries”. The US also found “no strong support and considerable opposition (from) EC countries” to allowing fluctuations within wider margins around par values. EEC states had no interest in greater flexibility: they were at that moment planning actively for monetary union based on reducing exchange rate flexibility between their currencies.

The outcome should not have surprised Volcker. It was a tactical error on the US’ part to believe partisan European technicians were open to technical arguments that would, if accepted, have had adverse implications for their governments. Any European concessions would have required political decisions based on a policy dialogue with senior representatives, not technicians. Volcker’s flexibility initiative was doomed from the start.

⁴⁵ See, for example, Krueger’s survey of the economic literature on balance of payments adjustment in “Balance of payments theory”, and her advocacy of floating exchange rates. But the issue was controversial and many academics opposed adoption of floating exchange rates, including Triffin, a leading scholar in the field: “I doubt whether floating exchange rates can really provide, in the long run, a viable bridge between persistently divergent national monetary policies. They are more likely to be a form of escapism...” (Triffin, “Evolution of the international monetary system”, 40)

Memorandum from Burns to President Nixon, 22 February 1969, commenting on President de Gaulle’s suggestion the US raise the dollar price of gold (Duncombe, Foreign economic policy, 304fn).

⁴⁶ Shultz arrived in Cabinet only a month before the exchange rate flexibility discussions began.

⁴⁷ Duncombe, Foreign economic policy, 333-34. George Willis served as Deputy to the Assistant Secretary of State for International Monetary Affairs during 1969-73.

Identifying International Monetary Reforms

Kissinger had instructed Volcker to produce preliminary ideas on US approaches to international monetary reform by 15 February, but immediately lost interest in the topic. Volcker and his Working Group nonetheless produced their initial thoughts in a wide-ranging paper: *Long Term Aspects of US International Monetary and Exchange Policy*.⁴⁸ It was, in fact, a rather gloomy meditation on what Strange called structural power.

Volcker's paper argued (in different language) the US possessed enough "negative" structural power to scrap the US' burdensome gold convertibility obligation, but did not possess sufficient "positive" structural power to control the structural consequences of such an action. The Treasury feared ending convertibility might be followed by the international monetary system splitting into competing blocs based on the dollar and gold, respectively. This was a reasonable expectation at the time, shared by some in London.⁴⁹ At its Summit in The Hague in 1969 EEC leaders had tasked Pierre Werner, Luxembourg's Prime Minister, with drawing up a plan for European monetary union, effectively a European currency bloc. This was expected to be a gold-based system. Any monetary plan would have to satisfy France, which was wedded to gold being any international monetary order's basis.⁵⁰

The Volcker Group paper judged the US' obligation to convert dollars to gold imposed "strain" on the US. It also threatened Bretton Woods regime stability because foreign central banks might initiate a run on US gold reserves. The US could not be master of its own monetary destiny, nor guarantee international monetary stability, unless it shed its convertibility obligation. While

⁴⁸ Duncombe, *Foreign economic policy*, 292-98. The first (and possibly final) draft of this undated confidential paper was prepared by George H. Willis, who also provided the Group with confidential papers on a possible French devaluation and US-UK co-operation for discussion on 3 February 1969. The *Monetary and Exchange Policy* paper was undated but its context makes clear it was produced in late January 1969 and circulated with the other papers to the Volcker Group on 31 January.

⁴⁹ The Bank of England archive contains an unusually indiscrete, but perceptive, letter from John Kirbyshire, Adviser to the Governors, to Mr Hurford Sharon dated 18 February 1970. Mr Sharon is described in the file as a well-connected US businessman. Kirbyshire speculated about the prospects for an over-valued dollar: "either the US Administration will allow the dollar to float or crawl against gold or SDRs, or we shall see the creation of a common external currency in Europe which would itself float or crawl against the dollar." (Bank of England file OV53/41)

⁵⁰ The background to and content of the 1970 Werner Report on European monetary union is discussed in Eichengreen, *European monetary unification*, 1321-23.

seeking policy direction on this point, the paper argued: “(p)erhaps one of the most important long-term problems facing the US is how to move out of this commitment (to gold convertibility) in a graceful manner without causing undue disturbance to the monetary system, and with a fair measure of international approbation, at some time in the future. It is not yet clear whether this can be done, and a breaking of the link may have to come in the context of some crisis and a threatened run on the dollar.”⁵¹ Prophetic words!

Volcker’s paper considered four policy options. These comprised a “no change” policy of continuing to operate convertibility, and three pro-active policy initiatives: freezing dollar balances held abroad; creating a new reserve settlement account; or, accepting two distinct currency blocs emerging, one using the dollar for international settlements, the other (European) using gold. The paper recommended the “no change” option, as practical and preferable to the three pro-active policy options because each would incur significant political and economic costs for the US.⁵² Volcker knew, however, a passive policy risked precipitating a destabilising run on US gold reserves and US inaction would demonstrate a lack of leadership, creating opportunities for other states to advance unwelcome initiatives.⁵³ Volcker knew something would have to be

⁵¹ Confidential Volcker Group paper, *Long Term Aspects of US International Monetary and Exchange Policy*, undated but distributed to Volcker Group participants for discussion at their 3 February 1969 meeting (Duncombe, *Foreign economic policy*, 295).

⁵² Freezing US dollar balances held abroad (which would comprise dollars held primarily by foreign central banks but also private funds deposited in the Eurodollar market) was rejected because it would jeopardise other states’ support for US monetary objectives: an IMF quota increase and SDR activation (expected to yield \$500m annually in additional reserves for the US). Creating a new reserve settlement account or permitting the international monetary system to split into competing dollar and gold blocs were also seen as harmful to US interests. Both were likely to require the US to settle some or all of its balance of payments deficits in gold or, once activated, SDRs. This implied the US would have to sacrifice real resources to fund its balance of payments deficits, and no longer simply issue new dollars to finance its deficits. The Volcker Group described the potential double hit to US finances as “dangerous”.

⁵³ His Group’s paper drew attention to FRG Finance Minister Schiller “reportedly” demanding multilateral exchange rate realignment. The Group feared this might devalue the dollar, which Washington opposed at that time (Duncombe, *Foreign economic policy*, 294). Moreover, a multilateral currency realignment organised by others might adversely affect US competitiveness, forcing the US to impose new border taxes, export subsidies and/or suspend convertibility to restore competitiveness.

The paper’s reference to Schiller’s views having been “reported” is somewhat coy. Burns’ diary entry for 3 April 1973 revealed Kissinger had sent an official to Copenhagen to inform Schultz, by then Treasury Secretary, about an intelligence report on Brandt’s views of the US position on international monetary issues. Burns added “apparently we know everything that goes on in German Cabinet meetings” (Burns and Ferrell, *Secret diary*, 94), an early, if somewhat overlooked, precedent for Edward Snowden’s revelations of US intelligence intercepts of Mrs Merkel’s telephone calls!

done, but what and when? He sought answers in a policy options paper he presented to Nixon and the Foreign Economic Policy Executive in June 1969.

Long Term Aspects of US International Monetary and Exchange Policy went nowhere in bureaucratic terms: the NSC never discussed it. It was important nonetheless for three reasons: it revealed US Treasury's willingness to end gold convertibility if satisfactory arrangements could be made for the US to abandon its obligation; it contained the suggestion of using a crisis as the excuse to shed convertibility, which Volcker and Connally would utilise in August 1971; and it revealed officials' views of the limits to US structural power.

The paper recognised the US had sufficient negative structural power to terminate convertibility, a US legal obligation to the IMF. However, the paper also recognised the US would not wish to exercise this power unilaterally because it lacked the positive structural power to control the consequences of such action. The paper recognised the US needed other states' co-operation if it were to replace gold convertibility with international arrangements more favourable to the US. The Treasury feared other states insisting the US should finance its balance of payments deficits other than in dollars. It especially feared the international monetary system fragmenting into competing, perhaps unco-operative, blocs, one - the "gold bloc" - being outside US control.⁵⁴

The Volcker Group paper is interesting in part because it contradicts two Realist schools of academic thought on US policy in this period: Strange's structural realism and Sterling-Folker's neoclassical realism⁵⁵. Strange argued the US demonstrated its structural power by bringing down the Bretton Woods regime unilaterally and installing a system of floating exchange rates in its place. The Volcker Group paper reveals officials believed the US could abolish gold convertibility unilaterally, but it should not do so because the US lacked the structural power to prevent the consequences damaging US interests. Sterling-Folker argued the US wrecked Bretton Woods because it favoured national sovereignty and policy autonomy over international co-operation. Yet the Volcker Group paper demonstrated US officials had good reason to fear the consequences of ending monetary co-operation with other states: they could

⁵⁴ Treasury papers during 1969-73 reveal a persistent fear of the international monetary system splitting into two blocs. The EEC's ambition to create a European monetary union nurtured this fear.

⁵⁵ See chapter 2 above for discussion of Strange's and Sterling-Folker's theories.

retaliate and damage US interests. In the officials' view, the limited gains from unilateral action were not worth losing co-operation's benefits.

Unaware of the future academic controversies they would ignite, the Volcker Group attempted to identify the US' way forward on international monetary reform, producing a paper for Nixon's consideration in June 1969: *Basic Options in International Monetary Affairs*.⁵⁶ Kennedy distributed it to Nixon and other members of the Foreign Economic Policy Executive, plus William Rogers, Secretary of State, for discussion on 26 June.

Basic Options asked Nixon to choose one of three options: "evolutionary reform"; suspending gold convertibility; or "massive" increase in the dollar price of gold (i.e. dollar devaluation).

The "evolutionary reform" option was the only one based on international co-operation, a requirements Nixon had stated in his Treasury staff pep talk. The proposed reforms included: \$4-4½ bn SDRs to be issued annually; an IMF quota increase in 1970; exchange rate realignment in 1969 (including deutschemark appreciation and French franc depreciation) followed by international agreement on Bretton Woods adopting more flexible exchange rate mechanisms; exploration of the reserve settlement account proposal; liberalising others' trade policies to facilitate US exports; and, "better" offset arrangements to help fund US military spending abroad.

The Volcker Group, with McCracken's support, favoured the "evolutionary reform" option.⁵⁷ Kissinger weighed in with strong support in a memorandum to Nixon that emphasised the political aspects of international monetary reform.⁵⁸ Kissinger saw the "multilateral negotiated option" as the best fit with US overall foreign policy. He believed its success "could mark a major milestone in building a truly co-operative Atlantic Community and represent a major foreign policy achievement for this Administration".⁵⁹ He

⁵⁶ The paper was circulated under cover of a Confidential Memorandum from Treasury Secretary Kennedy to President Nixon 23 June 1969 (Duncombe, Foreign economic policy, 343-44).

⁵⁷ CEA participation in Volcker Group meetings tied its economists into supporting "evolutionary reform". McCracken emphasised his support in a Memorandum to the President, sent through Kissinger's office on 25 June 1969 (Duncombe, Foreign economic policy, 351-53).

⁵⁸ Confidential Memorandum from the President's Assistant for National Security Affairs to President Nixon, 25 June 1969 (Duncombe, Foreign economic policy, 345-51) .

⁵⁹ In taking this approach Kissinger was playing back to Nixon points the President had made to British Chancellor Roy Jenkins when they met at the White House on 1 May, a meeting

thought the benefits of reducing the external international monetary constraints on the US to “safe” levels justified the US applying “considerable pressure on the Germans and others” to co-operate on reform. This, he recognised, would be hard labour. Kissinger forecast success would require a great deal of “negotiated effort”, including Nixon’s personal interventions at times, because the US needed to push Europeans to move further on SDR allocations, exchange rate flexibility and currency realignment than they wanted. The key players would be Germany - “the strongest surplus country”, although others in the EEC Six would “fear and resent any German attempt to impose its views” on them - and France “because of the desire of the rest of the Six for a common position”.⁶⁰ Kissinger concluded the US should pursue evolutionary reform, but if this failed it should unilaterally suspend gold convertibility to galvanize international monetary reform by forcing Europe to make unwelcome choices.

With Kissinger’s and McCracken’s support, Volcker steered Nixon towards agreeing the “evolutionary reform” option when presenting his Group’s paper in the White House Cabinet room on 26 June. Volcker warned Nixon the other options would threaten the dollar’s ability to play its “pivotal role ... as the world’s leading reserve and vehicle currency”.⁶¹ He highlighted Treasury perceptions of US structural power weaknesses. This, he argued, made it essential to maintain international co-operation and not attempt to impose reform on others. Massive dollar devaluation would increase the dollar value of US gold reserves, buying time for the US, Volcker argued, but the policy would be inflationary and inequitable, dividing the US from its allies: an antagonistic rather than co-operative option.⁶² Suspending gold convertibility might be

Kissinger attended. At that meeting Nixon had said de Gaulle’s recent departure from office made it necessary to “decide on the kind of Atlantic Community we wish (to build)”. International monetary reform would be part of that: “we needed imaginative ideas and not just to react to crises.” (See Confidential Memorandum of Conversation, 1 May 1969 in Duncombe, Foreign economic policy, 319-24)

⁶⁰ Kissinger dismissed both the UK (“financially prostrate”) and Japan (“simply does not play a role commensurate with its economic power”) as lacking influence.

⁶¹ Quoted in Silber, Volcker, 63

⁶² Kit McMahon, Executive Director at the Bank of England, thought dollar devaluation was a plausible option for the US and believed it had been discussed seriously within the Nixon administration (C. A. McMahon marginalia written on a Bank of England internal memorandum on the US economy, 11 February 1969; Bank of England archive file OV53/40). But Volcker stated “no one pressed the idea” (Volcker and Gyohten, Changing fortunes, 67). Dollar devaluation was unattractive to the US for foreign policy and domestic political reasons. The distributional consequences of devaluation were the opposite of those the US would have wished: devaluation would reward states that produced gold (USSR and South Africa in particular) or hoarded it (France) and penalise allies who had co-operated with the US by

forced on the US in a crisis, Volcker warned, and might be turned to the US' tactical advantage if the opportunity were taken to demand exchange rate realignment and systemic reforms as the price for the US restoring convertibility. But the US should not initiate convertibility suspension, Volcker cautioned, because allies would react badly and uncontrollably to any "power play" to replace the gold-exchange standard with a pure dollar standard.⁶³ Unilateral convertibility suspension risked fragmenting the international monetary system into competing dollar and gold blocs, severing Western co-operation; other states would impose controls on trade and finance, possibly including controls on interest, profit and dividend remittances to the US.⁶⁴

Nixon was not interested. He had not read the *Basic Options* paper. He had no questions at the end of Volcker's presentation. As Burns prepared to intervene, Nixon cut off discussion, stating as he left the meeting "Good job and keep me informed about where we stand".⁶⁵ That was the entirety of Nixon's guidance. Kennedy and Volcker took it as the mandate they had sought.

Nixon subsequently made his lack of interest in international monetary affairs explicit in a memorandum to his White House aides on 2 March 1970, stating "I do not want to be bothered with international monetary matters... I have no confidence in the Treasury people since they will be acting in a routine way. International monetary matters, incidentally, are a case in point in making the difficult decision as to priorities. I feel we need a new international monetary system and I have so indicated in several meetings. Very little progress has been made in this direction because of the opposition of Treasury".⁶⁶

voluntarily refraining from systematically converting their dollar reserves to gold (Japan, FRG, UK). Devaluation would bring domestic politics into play because the Gold Reserve Act of 1934 required the president to seek Congressional approval for devaluation. Nixon did not wish to give Congress the opportunity to criticise him for failing to defend the dollar and tag him as a "devaluation President" (Odell, "Emergence of flexible exchange rates", 72). The Gold Reserve Act gave the Treasury Secretary the discretionary authority to suspend gold sales. Congressional approval was therefore unnecessary when Nixon suspended gold convertibility in August 1971. Michael Bradfield, an assistant general counsel at the Treasury, briefed Volcker on these issues on 21 November 1970 (Silber, Volcker, 72).

⁶³ Silber, Volcker, 66

⁶⁴ Ibid., 66-67

⁶⁵ Matusow, *Nixon's economy*, 129, reported Nixon attended the meeting without having read the Volcker Group's report or having sought briefing.

⁶⁶ Memorandum from President Nixon to Ehrlichman, Haldeman and Kissinger, 2 March 1970 (Duncombe, *Foreign economic policy*, 94-95). Nixon asked for Burns to lead the work international monetary reform, an odd choice. Charles Coombs of the New York Federal Reserve Bank, who was responsible for all Federal Reserve operations in the gold and foreign exchange markets during 1961-75, was well-placed to judge. In his view, Burns had "little prior

Despite Nixon's scepticism, Kennedy and Volcker had made substantial progress by solving Bretton Woods' liquidity problems. No progress had been achieved on building an international consensus on increased exchange rate flexibility, although Kennedy and Volcker continued lobbying for this: the Treasury believed it was vital for achieving an efficient adjustment system.⁶⁷

Opportunities to advance other elements of the "evolutionary reform" package were cut off as the political wind changed in the US. The US economy slipped into recession in late 1969. The Republican Party was penalised for it in the 1970 congressional elections. This marked a turning point. The Foreign Economic Policy Executive, until then united behind the effort to reform and sustain the Bretton Woods regime, began to divide over how to deal with the regime's pressures on the US. Kissinger, McCracken and Volcker continued to prioritise the US' international responsibilities over domestic political concerns.

experience in international finance and several years were to elapse before his redoubtable intellect found time to focus on the foreign financial scene..." (Coombs, *Arena of international finance*, 205). Therefore hopes for further progress on international monetary reform rested in Treasury hands. Here, too, Coombs had serious reservations. He recalled "...as we moved into the early seventies, the issue of currency rate adjustment became almost exclusively a political matter for Treasury officials...the role of the Federal Reserve was severely curtailed (under) the Nixon Administration... the central bank meetings in Basel fell into disuse... the finance minister and their political lieutenants were not prepared for their new role, and their sporadic negotiations with one another came to resemble a dialogue of the deaf." (Ibid., xii-xiii).

⁶⁷ Volcker suggested to a G10 Deputies meeting held on 22 April 1970 that three forms of exchange rate flexibility might be adopted: widening the permitted margins around currencies' par values from plus or minus 1% to 2%; authorising governments to permit a 3% crawling peg adjustment of their parities within any one year; and, in cases of fundamental disequilibrium, permitting an exchange rate to float temporarily to help the authorities identify an appropriate new par value. His interlocutors' views were "negative and cautious", with only the FRG and Italy expressing any interest in his proposals (Duncombe, *Foreign economic policy*, 408).

In Washington, Volcker convened a meeting of his Working Group in late August 1970 to decide what to do about the forthcoming publication of a report IMF economists had been asked to produce: *The Role of Exchange Rates in the Adjustment of International Payments: A Report by the Executive Directors*. The IMF published its report on 13 September 1970. Volcker wondered if the US should capitalise on the report by pushing aggressively for changes in the IMF's rules on adjustment in 1970, or seek changes in 1971. The Group, perhaps recognising the US' failure to build any momentum in favour of reforming adjustment procedures, advised him to pursue the latter. See Confidential Volcker Group Paper, sent to Treasury Secretary Kennedy on 10 September 1970, originally distributed to the Working Group on 26 August (Duncombe, *Foreign economic policy*, 409-15).

Volcker's efforts to reform adjustment procedures fizzled out in 1971. His final attempt at co-operation-based reform involved him launching yet another exchange rate flexibility initiative in the IMF Board on 19 July 1971. Volcker proposed the IMF should permit exchange rates to move 4% annually without prior approval, a near-irrelevant figure when set alongside the havoc Burns was creating in the foreign exchange markets with his expansionary monetary policy. McCracken, an early supporter of greater exchange rate flexibility, thought this effort half-hearted. Volcker's reform initiative was doomed, McCracken warned Nixon, unless the president put his weight behind the proposal. See Unclassified Memorandum from the Chairman of the Council of Economic Advisers, McCracken, to President Nixon, 2 June 1971 (Duncombe, *Foreign economic policy*, 438-39). By then Volcker had given up on reform through co-operation: he was already planning to deal with a run on US gold reserves.

McCracken and Volcker also supported continuation of the “gradualist” anti-inflation programme begun in 1969, which was intended to reduce US inflation and meet international demands for Washington to ensure the dollar was “as good as gold”, but which had caused a recession and rising unemployment.

Nixon and Burns, however, prioritised the domestic political and economic agenda as the recession deepened. They wanted to end the recession quickly by adopting a new, expansionary macroeconomic programme that would create jobs and higher living standards. They wanted an economic boom to coincide with the presidential elections in 1972, prioritising this over concerns for higher inflation and its adverse impact on the international monetary system. Crucially, Nixon had the whip hand within the Foreign Economic Policy Executive, and he strengthened it by reshuffling the Executive’s personnel in 1970. Nixon gave the supportive Burns and Shultz (no ideological friend of Bretton Woods) more prominent roles at the Federal Reserve and OMB, respectively; he brought in John Connally to strengthen the domestic political focus of the Treasury’s economic policy; he recruited Peter Peterson in a vain attempt to tightening the White House’s grip on foreign economic policy; and he gradually marginalised McCracken. The overall effect was to move international co-operation and hegemony by consensus to the back-burner, while domestic, neomercantilist political considerations moved to the fore, underpinned by hegemony through domination. Burns set the pace for this in his new role as chairman of the Federal Reserve.

Burns’ Monetary Expansion, 1970-71

Nixon promised to reduce inflation (4.2% in 1968) in his election campaign.⁶⁸ He did not want this to be at the expense of employment. His core economic team in 1969 – the troika of Kennedy, McCracken and Mayo – proposed to reduce inflation gradually by progressively tightening fiscal policy.

⁶⁸ 4.2% was the annual average inflation rate for consumer prices in 1968, but the trend was upwards. The year-on-year inflation rate had reached 5% in November 1968 - the highest level since the Korean War. The civilian unemployment rate was then 3.3% (Stein, *Presidential economics*, 142).

Nixon agreed provided “gradualism” did not raise unemployment to 5%.⁶⁹ Their plans came unstuck when Federal Reserve chairman Martin, as if atoning for earlier inflationary sins, ignored gradualism and introduced a tight monetary policy in his attempt to crush inflation abruptly before retiring at the end of 1969.

Martin was an old central banker in a hurry. He was independent of the administration and had not signed up to gradualism. Having implemented an inflationary monetary policy during Johnson’s presidency, Martin took the opportunity of Nixon’s arrival to tackle inflation by raising interest rates sharply and cutting the broad money supply in 1969 (Table 4.3), despite the Nixon administration simultaneously tightening fiscal policy. High US interest rates sucked dollars into the US from the Eurodollar market and foreign central banks’ reserves. After years of decline, US gold reserves increased by almost \$1 bn as \$3.7 bn of capital flowed into the US, pushing its balance of payments into surplus.⁷⁰ Kennedy and Volcker were able to rebut European criticisms of lax US macroeconomic policies in 1969 by claiming the high US interest rates and fiscal surplus demonstrated Nixon’s efforts to bolster the Bretton Woods regime. It was not long before the US’ European critics were complaining about tight US macroeconomic policies damaging European trade and investment!⁷¹

⁶⁹ Nixon’s approved “gradualism” at the Cabinet Committee on Economic Policy meeting on 13 February 1969. His economic team advised him the policy would cut inflation to around 3% by the mid-term elections in 1970 without causing unemployment to rise above 4.4% (Matusow, *Nixon’s economy*, 16-18). Herbert Stein of the CEA who, along with McCracken, Kennedy and Mayo helped design the “gradualist” fiscal policy, recalled “Nixon accepted the priority of the inflation problem but he was allergic to unemployment” (Stein, *Presidential economics*, 135).

⁷⁰ By nearly 28 million fine troy ounces, equivalent to \$970 m. The FRG coped with the Martin-induced demand for dollars only by selling \$500m of gold to the Federal Reserve.

⁷¹ See, for example, the Confidential Telegram from the US Embassy in Rome to the State Department of 27 March reporting Volcker’s discussion with Italy’s Treasury Minister Colombo. The latter complained US efforts to adjust were, as early as March, “causing difficulties for Italy’s own balance of payments... High world interest rates caused by tight money in the US were attracting capital from Italy” (Duncombe, *Foreign economic policy*, 314-16). Kennedy, having visited Belgium, France, FRG, the Netherlands, UK and EEC Commission during 2-10 December 1969, sent a confidential memorandum to Nixon on 15 December 1969 reporting his findings, including: “I have found great concern over the effect which our tight money and high interest rate policy were having on European economies” (Duncombe, *Foreign economic policy*, 85-87).

Table 4.3. US economy: macroeconomic indicators, 1968-71 (annual averages, in per cent unless otherwise indicated)⁷²

	1968	1969	1970	1971
Policy variables				
Narrow money growth (M1)	8.1	3.3	4.3	6.5
Broad money growth (M3)	9.9	-0.9	12.1	12.3
Interest rate*	5.7	8.2	7.2	4.7
Federal budget balance/GDP	-3.0	0.3	-0.3	-2.3
Outcomes				
Real GNP growth	4.4	2.6	-0.3	3.0
Inflation**	4.2	5.4	5.9	4.3
Civilian unemployment rate	3.6	3.5	4.9	5.9
Current account balance \$bn	0.6	0.4	2.3	-1.4

* Federal funds rate. ** Consumer prices.

Martin's monetary policy helped Kennedy's and Volcker's international monetary reform credibility abroad, but infuriated Nixon at home. He replaced Martin with Burns as chairman of the Federal Reserve as soon as was constitutionally possible, and greeted Burns' Congressional confirmation with a smile, saying "Dr. Burns, please give us some money".⁷³ Burns complied.

Burns' arrival at the Federal Reserve in December 1969 changed macroeconomic policy. Burns justifiably dropped Martin's "tight money" policy to tackle a domestic liquidity crisis that emerged in Spring 1970.⁷⁴ But the change in monetary policy philosophy went beyond crisis management. Burns' diary reveals he saw no distinction between the US national interest and the

⁷² Sources: IMF *International Financial Statistics Yearbook*, 1979, except: unemployment rate – Bureau of Labour Statistics, US Department of Labour website; and current account balance – US Department of Commerce's Bureau of Economic Analysis website (www.bea.gov/international/index.htm) Table 1 International Transactions, 1960-Present.

⁷³ Coombs, *Arena of international finance*, 206

⁷⁴ Martin's monetary policy precipitated not only a mild recession starting late 1969 and continuing into 1970, but also a domestic liquidity crisis. By May 1970 this began to drag some of the US' largest companies toward bankruptcy. Household names such as Penn Central went bankrupt; defence contractor Lockheed required a Federal bail-out to avoid the same fate (Galbraith, "Nixon administration", 83-94). US financial markets began to panic, fearing the Federal Reserve's monetary squeeze would turn a mild recession into a depression. The Federal Reserve had to act: thus there were sound financial stability reasons for Burns to reverse Martin's policies in 1970.

President's political interests.⁷⁵ He shared Nixon's view the US needed a looser monetary policy and a buoyant economy - and not simply for political and electoral reasons - and let rip on the money supply. He was undeterred by the damage this inflicted on the Bretton Woods regime.

Burns turned on the monetary taps. Broad money (M3) soon grew rapidly (Table 4.3).⁷⁶ A tidal wave of money swept across the US economy and abroad. Domestic inflation rose to 5.9% in 1970, well ahead of the rate during Nixon's election campaign. Dollars flooded out of the US, piling up in foreign central banks' reserves (chart 4.2).⁷⁷ The irresistible surge in dollars caused Canada to float its dollar in May 1970. Although foreign grumbling about the expansionary monetary policy began as early as May 1970, European and Japanese markets initially remained calm, taking the additional dollars in their stride throughout 1970 until dollar saturation crises broke in foreign exchange markets in May and August 1971.⁷⁸

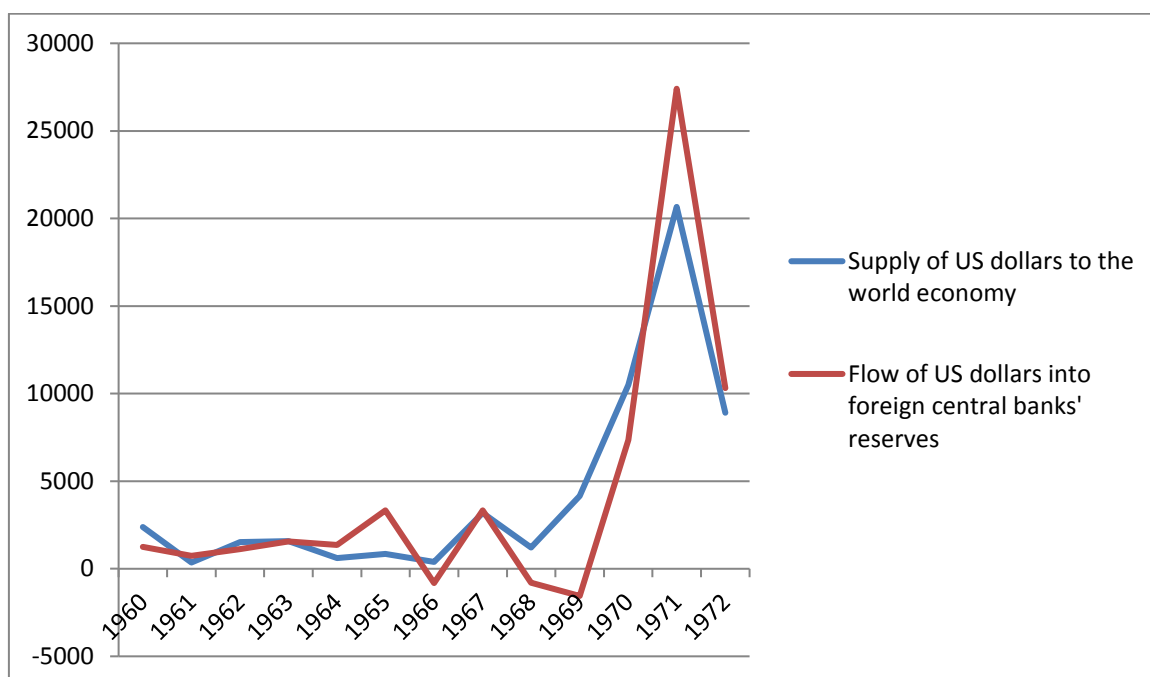
⁷⁵ Burns' diary entry for 21 March 1971 reveals he requested a meeting with Nixon at which he told the President "there was never the slightest conflict between me doing what was right for the economy and my doing what served the political interests of RN (and) that if a conflict ever arose between these objectives, I would not lose a minute in informing RN and seeking a solution together..." Nixon responded that he had every confidence in Burns' ability to "handle the economics and the politics" (Burns and Ferrell, Secret diary, 39-40).

⁷⁶ Poole gives Burns' low marks for his handling of monetary policy: "The real problem with monetary policy during the Burns years was not that monetary growth fluctuated quarter by quarter, but that its average rate was too high and fluctuations around the average were pro-cyclical... monetary policy contributed to many of the woes of the 1970-78 period" (Poole, "Burnsian monetary policy", 475).

⁷⁷ Foreign central banks and governments' dollar assets rose by \$7.4 bn in 1970 and an unprecedented \$27.4 bn in 1971 (IMF *International Financial Statistics* data).

⁷⁸ Kennedy and Volcker met Giscard d'Estaing, France's Minister of Economy and Finance, and a French delegation at Camp David on 3-5 May 1970. It was a tetchy exchange. The US delegation complained dollar overvaluation was damaging US competitiveness and boosting US imports. They asked for French support in reforming the Bretton Woods regime's adjustment mechanism to permit more flexibility in exchange rates. The French side disputed the claimed loss of competitiveness and Giscard d'Estaing mocked the US forecast of its 1970 balance of payments (Volcker had forecast a US current account surplus of around \$1.5 bn). Giscard argued the main impediment to adjustment under Bretton Woods was political: governments were reluctant to use the mechanisms available to them. In Giscard's view, the IMF's *Articles of Agreement* had permitted a temporary float of the German Mark to establish a new exchange rate, and as for wider margins, if anyone needed them it was the US! See Confidential Memorandum of Conversation, 20 May 1970 (Duncombe, Foreign economic policy, 392-407).

Chart 4.2 Annual flow of US dollars into the World Economy and Foreign Central Banks (\$m), 1960-72⁷⁹



Burns' expansionary monetary policy was economically appropriate in 1970, but continued expansion in 1971 and beyond was hugely damaging.⁸⁰ The policy was driven largely by a combination of Burns' inclinations and relentless White House pressures from the president and his aides to create an economic boom in time for the 1972 presidential elections.⁸¹

⁷⁹ Sources: IMF *International Financial Statistics Yearbook*, 1979 for US capital account data and central banks' acquisitions of dollars; Bureau of Economic Analysis, US Department of Commerce website for current account data (www.bea.gov/international/index.htm), Table 1 International Transactions, 1960-present. The global annual supply of US dollars is calculated as the sum of the US' payments balances on current and capital accounts. The annual sum of dollars acquired by central banks may exceed the total annual supply of dollars because of divestment of dollar holdings by foreign governments, international institutions and/or the private sector, or because central banks have sold gold or other foreign exchange to the US to obtain dollars.

⁸⁰ Poole analysed the Federal Open Market Committee's (FOMC) minutes: "from 1970 through 1972 Burns' attitude was expansionist. He did express concern at times when money growth was especially rapid, but on the whole his comments reflected much more concern over unemployment than over inflation. He over-estimated the slack in the economy. Relying on controls to suppress inflation, Burns continued to advocate expansion in the FOMC in December 1972!" (Poole, Burnsian monetary policy, 480)

⁸¹ The White House pressures on Burns, sometimes intense, are catalogued in particular by Abrams, in "How President Nixon pressured Arthur Burns", and also in Pierce, "Political economy of Arthur Burns", Poole, "Burnsian monetary policy" and Wells, *Economist in an uncertain world*. In addition to lobbying Burns in telephone calls and meetings, Nixon sought to put pressure on Burns by denying approval for Burns' appointments to the Federal Reserve Board's governors, threatening to end the Federal Reserve's constitutional independence and, in 1971, by mounting a public smear campaign (through White House aide Colson), which

Burns increased the US' broad money supply by one quarter in just two years. This helped propel the US economy out of recession, but also fuelled domestic inflationary pressures, increased unemployment and weakened the US current account balance. In May 1970 Burns attempted to contain his monetary policy's domestic impact by proposing the Nixon administration adopt an incomes (but not prices) freeze. Burns wanted to ensure the entirety of his monetary expansion would fuel increased US spending and employment and not be diluted by the impact of rising costs and on the population's spending power. Nixon rejected Burns' proposed controls as politically unacceptable in 1970, although he returned to the idea following year.

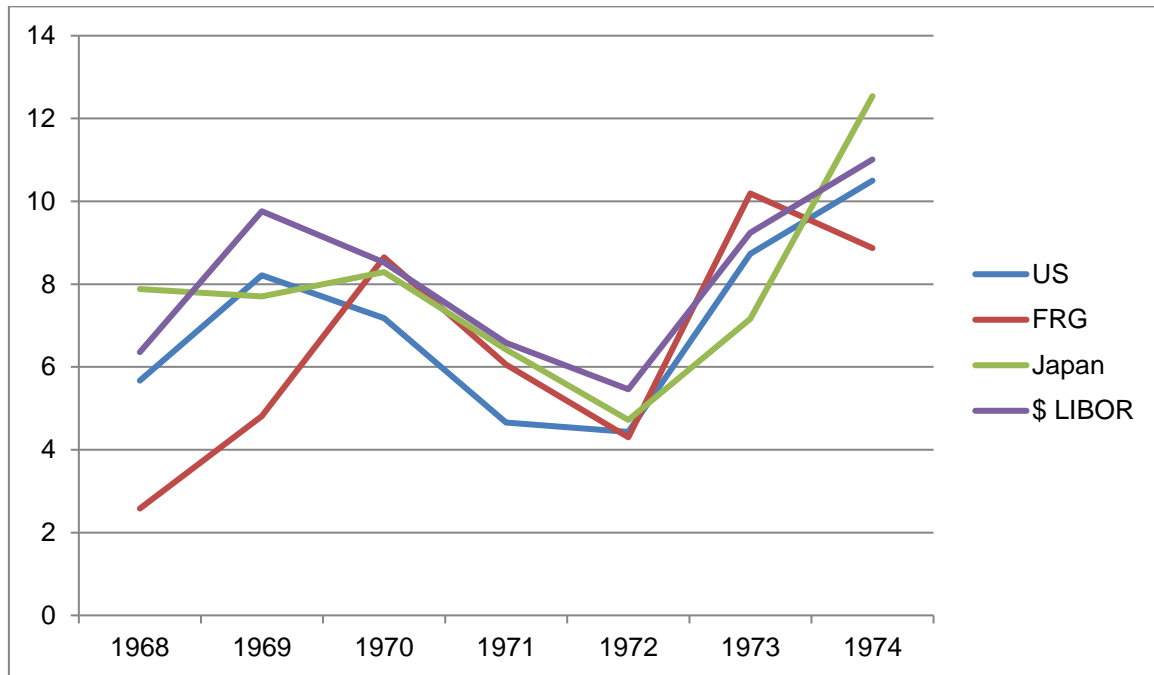
Burns' monetary expansion and his willingness to hold US interest rates below Europe's during 1970-72 encouraged speculative capital outflows from the US to the Eurodollar market and to currencies likely to appreciate against the dollar (Table 4.3 and charts 4.2 and 4.3). No fixed exchange rate system could cope with so great an expansion of its main reserve asset. The increased supply of dollars fed Japan's seemingly insatiable demand for dollar reserves, but Europe's absorptive capacity was tested severely. The large dollar inflows provoked turmoil in foreign exchange markets in both May and August 1971. European central banks struggled to maintain their fixed exchange rates against the dollar and simultaneously deal with the domestic inflationary consequences of large-scale capital inflows boosting their national money supplies. Overwhelmed, they closed their foreign exchange markets during the May and August 1971 crises. Burns professed support for the Bretton Woods regime,

shook Burns badly. Haldeman recorded a meeting at Camp David on 5 July 1971 in which Nixon instructed Colson to "target" Goldstein at the Bureau of Labour Statistics and Burns, saying "we're going to have to start playing a harder game with Arthur" (Haldeman, *Diaries*, 314). By 28 July stories were appearing in print media to the effect the Federal Reserve was on course to lose its independence and Burns had requested a massive (\$20,000) salary increase for himself at a time he was calling for a pay freeze for others. Haldeman, (*Ibid.*, 331) observed Burns was "upset" by the White House's treatment of him.

Nixon believed monetary policy was the main lever by which policymakers moved the economy. Shultz, having been convinced by economist Arthur Laffer that each \$1 increase in the money supply could boost nominal GNP by \$4-5, was especially keen to press Burns to cut interest rates (Pierce, "Political economy of Arthur Burns", 487). There were times when Shultz urged Nixon to apply still greater pressure on Burns, for example telling the president on 14 February 1972 "(Burns) needs to do everything he can do. We want low interest rates. What's the problem there? So we don't have a return flow of money from Europe? So what? Keep the money supply going up! ...The economy has to be good, (a) strong expanding economy this year. So much at stake on that" (quoted from a White House tape in Abrams, "How President Nixon pressured Arthur Burns", 183). Burns responded bitterly to Shultz-led pressures.

including fixed exchange rates and gold convertibility, but his domestically-oriented monetary policy helped wreck it.⁸²

Chart 4.3 Money market interest rates, 1968-74 (annual average in per cent)⁸³



US neomercantilism

By 1969 the US' capacity to project power and influence was becoming increasingly stretched - over-stretched, perhaps.⁸⁴ Volcker recalled feeling a sense of unease on his appointment to the Treasury

“... even though the US trade and current accounts remained in surplus, it was impossible to dismiss the idea that our balance of payments problem had become chronic, and that one day a change of some size would be needed in the exchange rate of the

⁸² Odell, “Emergence of flexible exchange rates”, 68

⁸³ Source: IMF *International Financial Statistics Yearbook*, 1980. Federal funds rate for US; call money rate for FRG and Japan; Eurodollar rate in London for LIBOR.

⁸⁴ Kennedy assessed “...the United States now runs the risk ... of what might roughly be called ‘imperial overstretch’; that is to say, decision-makers in Washington must face the awkward and enduring fact that the sum total of the United States’ global interests and obligations is now far larger than the country’s power to defend them all simultaneously” (Kennedy, *Rise and fall of the great powers*, 515).

dollar... it was clear we could not manage an abrupt change, maybe any change at all, without undermining the whole (Bretton Woods) system".⁸⁵

Volcker's fears were well-founded. Treasury Secretary David Kennedy was soon warning Nixon of a "startling ... near-record" balance of payments deficit in the first quarter of 1969, arguing "our balance of payments is in poor shape".⁸⁶

If interest rate differentials with Europe - entrusted to Burns after 1969 - drove the US capital account, then trade drove the current account. The US trade surplus had covered US government overseas spending on military and development assistance during 1945-65, but the trade surplus almost disappeared thereafter (Table 4.2).⁸⁷ Many were shocked, nonetheless, when in 1971 the US recorded its first trade deficit that century. US-based producers were finding it harder to maintain their share of overseas markets; and import penetration of US home markets was rising, a consequence of post-war economic recoveries in Europe and Japan.⁸⁸ The large and protracted trade deficits with just three states - Japan, the FRG and Canada - gave rise to particular concerns, putting US free-traders on the defensive.⁸⁹

⁸⁵ Volcker and Gyohten, *Changing fortunes*, 66

⁸⁶ Confidential Memorandum from Treasury Secretary, Kennedy, to President Nixon, 13 May 1969 (Duncombe, *Foreign economic policy*, 52-55)

⁸⁷ Recession boosted the trade surplus in 1970, but it remained low by historical standards.

⁸⁸ Peterson's report, *The United States in a Changing World Economy*, discussed below, observed the US' share of world exports had declined from 18.2% in 1960 to 15.4% in 1970.

⁸⁹ Canada was seen as a special case. Its surpluses largely reflected a trade concession the US had made which resulted in US producers moving significant volumes of automobile and parts production and assembly to Canada.

The FRG's surpluses were, in US eyes, linked to the EEC's restrictive trade practices. These closed off many US agricultural (and other) exports, annoying an important political constituency in the US. Washington became increasingly concerned about EEC trade practices when the UK - a large market for US agriculture - Ireland and Denmark agreed to join the EEC and its customs union. US negotiators pressed the European Commission for compensation.

Japan operated a highly protected home market and a predatory state-organised sector-by-sector approach to export domination. Treasury Secretary Connally told *Time* magazine "The Japanese are still fighting the war, only now instead of a shooting war, it is an economic war. Their immediate intention is to try to dominate the Pacific and then perhaps the world" (Matusow, *Nixon's economy*, 135).

Textiles proved to be an especially sensitive sector in US-Japanese trade. Japan exported \$500m to the US but imported only \$10m in 1969. With 11,000 US textile workers losing their jobs in 1970, the 2.5m remaining workers lobbied Nixon and Congress to protect their industry from Japanese competition (Small, *Presidency of Richard Nixon*, 145-46). Nixon's attempt failed, but the Democratic Congressman Wilbur Mills, chairman of the House Ways and Means Committee, took it upon himself to negotiate directly with the Japanese government, persuading them to accept a three-year voluntary export restraint agreement. It was a watered-down version of the deal Nixon thought he had agreed with Sato. This angered Nixon and

Protectionism, long denounced by US leaders as damaging US global economic and hegemonic interests, started to gain political respectability. One third of the US Senate co-sponsored a proposal to introduce GATT-illegal mandatory restraints on steel imports in 1968.⁹⁰ Congress introduced further protectionist bills during 1969-71. Trades union leaders started to switch their support from free trade to protectionism. Seeking to boost his support among blue collar workers and in the South, Nixon gave 1968 election commitments to protect US textile producers from Japanese competition. Having failed to make progress with Japan in 1969, Nixon negotiated a bilateral voluntary export restraint agreement with Japan's Prime Minister Sato in 1970. They shook hands on a deal, but Sato failed to deliver: Japanese textile exports continued unabated. Resentments grew as allies seemed to benefit disproportionately from US hegemony, while at the same time clinging to their own, out-dated protectionist trade practices.⁹¹ This soured the public's view of the Republican Party's economic policy performance ahead of the 1970 mid-term elections.

Nixon was rattled by the disappointing Republican Party showing in the 1970 elections.⁹² His hopes for a Republican-majority Congress were shattered.⁹³ He blamed the election result on the economy's poor performance; and he blamed that on his economic team.⁹⁴ Nixon attributed his defeat in the

Senator Strom Thurmond of South Carolina, a Nixon ally who opposed Mills' deal because it left man-made fibre producers (South Carolina's speciality) vulnerable to Japanese competition. Nixon backed Thurmond. Mills' trade deal became stuck in Congress: Mills would not allow the administration to advance its GATT-illegal mandatory import restriction scheme through Congress, and the administration would not support Mills' VRA deal with Japan.

⁹⁰ Matusow, *Nixon's economy*, 119. GATT rules permitted one state to impose voluntary restrictions on exports to another, but mandatory restrictions imposed by one state on another were illegal.

⁹¹ Mastanduno identifies these as: security; relatively unfettered access to US markets for their exports on terms not fully reciprocated in their domestic markets; global liquidity; reserve accumulation; and, financial support in emergencies (Mastanduno, "System maker", 126-27).

⁹² The Republican Party won two additional seats in the Senate, but lost nine (net) in the House.

⁹³ A Republican majority did not appear unrealistic as late as September 1970. At a meeting at Camp David on 12 September 1970, Nixon told his advisers "(we) should gear everything to '72 re-election and winning Congress. Not a bad approach anyway. In most cases, what's good politically will be good otherwise too" (Haldeman, *Diaries*, 194).

⁹⁴ The shallow recession that began in the fourth quarter of 1969 had deepened by the fourth quarter of 1970, when output was 4.1% below the previous year's level. The civilian unemployment rate had almost doubled to 7.5% in Q4 1970 and inflation had increased to 6.3% in Q3 1970 (Matusow, *Nixon's economy*, 82). On 5 November 1970 Nixon told Haldeman "Without economic drag (we) would have carried both the House and Senate" (quoted in Matusow, *Nixon's economy*, 83). Nixon returned to this theme on 18 November 1970; Haldeman records Nixon telling Ehrlichman "he was seriously considering a complete change in his economic advisers since they had failed the one prime objective he had set, to keep

1960 presidential election to the recession Martin's tight monetary policy had created; he did not want to risk another recession in 1972.⁹⁵

Nixon wanted a politically-focussed economic team and refreshed the Foreign Economic Policy Executive in search of it. He had already replaced his first budget director, Mayo, with Shultz; and Burns had replaced Martin at the Federal Reserve. Nixon told a White House aide he no longer had confidence in McCracken, who found himself gradually frozen out of important meetings.⁹⁶ Most importantly, Nixon replaced the low-key Kennedy at the Treasury with the high-profile politician, John Connally.⁹⁷ Lacking economic expertise and ideology, Connally did not do economics, but he understood politics and he did do political economy. Nixon gave Connally a strong steer on 1971's fiscal policy, putting forward an expansionary budget and publicly declaring himself a "Keynesian".⁹⁸ Nixon wanted the economy's pump well and truly primed to deliver a boom in 1972. After achieving broad fiscal balance, taking 1969 and 1970 together, Connally's Treasury duly set fiscal policy on an expansionary course, increasing the budget deficit by 2% of GDP in 1971.

Nixon also attempted to strengthen the White House's grip on foreign economic policy.⁹⁹ He created the Council on International Economic Policy

unemployment below 5% in October (1970). (He) doesn't want to take any chance on screwing up in 1972. (The) problem is not their advice, it's that the don't get in and fight" (Haldeman, Diaries, 211).

⁹⁵ Martin was first appointed chairman of the Federal Reserve in 1951. He completed his predecessor's term as well as serving two full terms himself. He is well-known for describing his job as requiring him to make unpopular decisions by "leaning against the wind" or "taking the punch bowl away just as the party gets going"; he was unpopular with Nixon, however, primarily for his role in creating recessions in 1960 and 1970.

⁹⁶ Matusow, Nixon's economy, 33 and 106. Despite McCracken offering his resignation, Nixon kept him in his post until the end of 1971, when Stein was appointed CEA chairman. Stein's influence was too limited for him to be considered a member of the Foreign Economic Policy Executive. He was a fiscal specialist, a supporter of the administration's early "gradualism" policy and of achieving small budget surpluses, as in 1969. But Connally and Shultz (and later Simon) set fiscal policy without reference to Stein's fiscal rules. Moreover, Stein had little influence on foreign economic policy. In truth, he personified the economist in an ornamental role.

⁹⁷ Nixon appointed Connally on 14 December 1970; Congress confirmed the appointment in time for Connally to take up his position on 11 February 1971.

⁹⁸ Nixon's intentions could not have been clearer. In his State of the Union message in 1971 he told Congress he intended to introduce an expansionary budget as the major instrument for achieving full employment: "It will be a full employment budget, a budget designed to be in balance if the economy were at full employment. By spending as if we were operating at full employment, we will help bring about full employment." In a subsequent media interview Nixon declared "Now I am Keynesian, as I have duly noted." (Stein, Presidential economics, 173)

⁹⁹ Nixon probably did not foresee the extent to which Connally's appointment would change the way economic policy would be made and implemented. Unlike Kennedy, Connally adopted a direct approach to making and implementing policy: he discussed it one-on-one with

(CIEP) in January 1971 and recruited Chicago businessman, Peter Peterson, as its first Director. Peterson was ultimately a marginal figure in the administration, squeezed out of the White House after losing a turf fight with Connally. By then, however, he had steered Nixon into changing course on foreign economic policy. He demonstrated how other states' protectionism was damaging US trade and employment. He persuaded Nixon that taking steps to liberalise other states' trade policies could improve the US trade balance, create jobs and win votes. Aligning US foreign economic policy objectives with those of the expansionary domestic economic programme could help Nixon win re-election. For Nixon, the opportunity to simultaneously enhance his electoral prospects, US economic power and hegemony was irresistible.

Peterson's breakthrough came in the first half of 1971. He reported on the US' international position in *The United States in a Changing World Economy*.¹⁰⁰ The final report was discussed by CIEP members at a specially convened meeting at Camp David on 9-10 July. Kissinger's NSC, realising the report would stir up a hornet's nest, blocked its publication. However, early drafts of Peterson's report had reached CIEP members, ensuring Peterson's message was distributed widely within the administration. Some officials absorbed its message very quickly. Connally, for example, used Peterson's argument to reject Giscard d'Estaing's call for the US to devalue at their bilateral meeting in late May 1971 and it informed a speech he made to a shocked conference in Munich at the end of May.¹⁰¹ Administration officials, including Peterson, also began to use the draft report in official briefings, exciting the increasingly strong protectionist pressures in Congress.¹⁰²

the president. Connally went over the heads of the senior White House staff - including the newly appointed Peterson - who tended to act as intermediaries in Nixon's relations with all other members of the Cabinet, often dominating those relations. Numerous turf fights ensued between the Treasury and White House staff, which Connally always won until he decided to resign.

¹⁰⁰ Secret CIEP Study Memorandum 7, distributed to members of the CIEP on 30 June 1971 and to President Nixon under cover of a memorandum from Peterson on 2 July; Duncombe, *Foreign economic policy*, 161

¹⁰¹ Giscard d'Estaing met Connally and Volcker to discuss international monetary affairs on a visit to Washington on 20 May 1971. The Treasury's confidential official record contains the following: "What good would it do, (Connally) asked rhetorically, if we should devalue? He pointed out for example that yen revaluation would in itself not much help the U.S. because of the many Japanese restrictions on imports." See Confidential Memorandum of Conversation, 20 May 1971; Duncombe, *Foreign economic policy*, 434-37

¹⁰² Bergsten, a member of Kissinger's NSC staff, argued the US' main foreign economic policy initiatives in the past, by which he meant the Bretton Woods regime, Marshall Aid and the Kennedy Round, had been taken for foreign policy reasons. But there was now pressure to

Peterson had tapped into an old theme in US politics, as old as a hegemon complaining about free riders.¹⁰³ His evidence of other states' trade transgressions appeared to explain how unfair trade practices abroad enabled competitors to steal US markets and jobs. Moreover, Peterson showed dollar depreciation alone would not restore US competitiveness: the non-tariff barriers blocking US exports - such as Japan's limits on computer imports - would be unaffected by depreciation improving US price competitiveness.¹⁰⁴ If US pressure removed the non-tariff barriers, huge US gains might follow. Peterson calculated each additional \$1 bn of US exports would create around 60-80,000 US jobs. Eliminating the US balance of payments deficit through increased exports (or lower imports) might therefore create 500-750,000 jobs and, possibly, a similar number of grateful voters in the presidential election.¹⁰⁵ Peterson's report also pointed to a further bone of contention: Europeans were paying only \$800m of the \$1.7 bn. annual costs of stationing US troops in Europe.¹⁰⁶ That money could be used to create US jobs.

Peterson had shown how US trade policy could help Nixon's re-election prospects by boosting US employment. His neomercantilism grabbed Nixon's and Connally's attention by converting obscure international trade and monetary technicalities into the domestic employment issue central to Nixon's domestic

reverse these priorities and make foreign policy the servant of foreign economic policy. He claimed "wide support for this in Congress". See not classified Memorandum from Fred Bergsten of the National Security Council Staff to the President's Special Assistant for National Security Affairs, Kissinger, 21 April 1971; Duncombe, *Foreign economic policy*, 155-56.

Stein's position in the Council of Economic Advisers enabled him to observe a "politically significant" number of US companies were complaining about foreign competition by 1971 and wanted protection (Stein, *Presidential economics*, 165). Organised labour had reversed its traditional support for free trade in favour of protection by 1970, prompting Congressmen to propose protectionist legislation, including the Mills trade bill in 1970 and the Burke-Hartke bill in 1971 (Odell, *Emergence of flexible exchange rates*, 72). Senate Majority Leader, Mike Mansfield, meanwhile, attempted (unsuccessfully) to persuade Congress to cut funding for US forces abroad, hoping to push these costs onto US allies.

¹⁰³ The US under President Eisenhower began to intensify "the drive for the removal of discriminatory restrictions abroad against US exports" (Wallich, "Government in action", 103). During the period of dollar shortage (1945-58), Wallich argued, other states justified their use of discriminatory trade practices as a means of conserving scarce dollar reserves. After Europe's and Japan's return to full convertibility, however, the US viewed such trade restrictions as pure and discriminatory protectionism.

¹⁰⁴ Matusow provides details of Peterson's views on the impact of EEC barriers to US agriculture, preferential trade deals between European states and their former colonies, and Japanese cartels and public procurement systems (Matusow, *Nixon's economy*, 133).

¹⁰⁵ *Ibid.*, 136.

¹⁰⁶ *Ibid.*, 134

political and electoral priorities.¹⁰⁷ Nixon aimed to build a “New Majority” coalition to support his re-election. He wanted to draw in unionised and blue collar workers squeezed by (apparently) unfair foreign competition. Adopting neomercantilism would attract their support. The cost, upsetting US trade partners, worried the State Department, but not Nixon.¹⁰⁸ And Connally relished a fight.¹⁰⁹ They embraced Peterson’s analysis enthusiastically and pursued a pro-active Realist, relative gains, neomercantilist trade strategy.

End Game: the “New Economic Policy” Brings Bretton Woods’ Demise

Volcker was the intellectual inspiration for binding a neomercantilist trade policy to US international monetary policy, thus creating a unified foreign economic policy. Connally arrived in the Treasury largely ignorant of international monetary affairs.¹¹⁰ Volcker prepared a substantial briefing pack on the US’ international monetary problems, briefing his new boss orally on the policy options in March 1971.¹¹¹ Volcker distilled his briefing into a single, short, highly classified paper, *Contingency*, which to all intents and purposes

¹⁰⁷ Kissinger observed “By early August protectionist sentiment and talk about retaliation against discriminatory trade practices were increasing.” Peterson was urging import controls; Connally wanted an import surcharge (Kissinger, White House years, 953-54).

¹⁰⁸ In a confidential analysis, an alarmed State Department warned of “... serious political fall-out if world economic co-operation deteriorated. We cannot expect the same co-operation on political and security issues from our major allies in an atmosphere of increasing acrimony over economic issues.” The State Department’s analysis drew attention to the many areas of potential friction: trade in textiles, shoes and agriculture; high tariffs and quantitative trade restrictions abroad, especially Japan and through EEC enlargement from six to nine states; monetary issues, including exchange rate flexibility mechanisms, the two-tier gold market and the SDR system not yet working; volatile short-term capital movements and the US’ balance of payments deficits. The State Department was worried by growing protectionist sentiment in Congress and weakening US public support for a liberal world economic order – the very things Nixon and Connally wished to profit from politically. See Confidential Department of State Paper, *International Economic Strategy for the 1970s*, 16 March 1971; Duncombe, Foreign economic policy, 133-40

¹⁰⁹ Kissinger commented on 11 November 1971 “Connally is like all Texans, and is just basically anti-foreigner” (Haldeman, Diaries 372).

¹¹⁰ “When I took over as Secretary of the Treasury, I did so with feelings of trepidation. I was not an economist; I had really never studied monetary affairs” (Connally and Herkowitz, In history’s shadow, 235).

¹¹¹ Silber, Volcker, 76-78. Volcker recalled that when briefing Connally orally, he suggested the policy package should include a temporary wage/price freeze to convince foreign governments the US was serious about controlling inflation, while demanding a 15% depreciation of the dollar as a precondition for restoring convertibility.

constituted the main international elements in the “New Economic Policy” Nixon would announce to a startled US public on 15 August.¹¹²

According to Volcker’s *Contingency* paper, US objectives were:

- a significant revaluation of the major European and Japanese currencies;
- “improvements” in European and Japanese trade policies;
- the US to pay a reduced share of foreign aid in recognition of its defence burdens; and,
- fundamental reform of the Bretton Woods regime, including greater exchange rate flexibility, the end of gold’s role and prevention of “excessive” controls.

It is striking Volcker included non-monetary objectives - the trade policy and burden-sharing measures - in a package one might have assumed would concentrate on currency realignment and international monetary reform. This reveals the extent of neomercantilist thinking in the Nixon administration. Linking exchange rate policy, aimed at making the US more competitive, to job-creation through trade policy was also telling.

Volcker’s briefing was unsentimentally realistic: he expected Burns’ extravagant monetary policy to create foreign exchange market crises. Volcker was explicit about the US using these crises to leverage US hegemony and advance US objectives. The *Contingency* paper recommended the US should “permit foreign exchange crises to develop without action or strong intervention by the US”, then use the following tactics to exert negotiating leverage:

- suspend gold convertibility;
- impose trade restrictions;
- use diplomatic and financial interventions to frustrate US opponents;
- cut the US military presence in Europe and Japan; and,
- float the dollar and, if other measures proved ineffective, threaten to tolerate floating “indefinitely”.¹¹³

Volcker’s predicted crises soon arrived. There was a run on the dollar in May 1971: the massive outflow of Burns’ newly-created dollars had caused indigestion in Europe. The crisis appears to have been triggered by FRG

¹¹² Confidential “Eyes Only” paper prepared in the Department of the Treasury, “Contingency”, 8 May 1971; Duncombe, Foreign economic policy, 423-27

¹¹³ Ibid., 423-27

Finance Minister Schiller's remarks. At a meeting with EEC Finance Ministers on 26-27 April he was reported to have suggested the EEC should respond to huge inflows of US dollars by either floating their currencies jointly against the dollar (and thus initiate the second, rival currency bloc the US Treasury feared), or insisting jointly on other states agreeing to multilateral exchange rate realignment. France rejected both proposals; the EEC did nothing. But markets feared a currency realignment and dumped dollars for deutschemarks.

The UK's IMF Executive Director reported to London on two Executive Board meetings held on 5 May 1971.¹¹⁴ In the first meeting the FRG's Executive Director, Schweitzer, revealed the Bundesbank had taken in \$100m that Monday, \$956m on Tuesday and over \$1 bn in the first 50 minutes on Wednesday morning, obliging the Bundesbank to close its foreign exchange market.¹¹⁵ Schweitzer commented sourly it was unclear whether these inflows reflected "fundamental disequilibrium" or interest rate differentials. In a barb directed at the US Executive Director, he called on all IMF Member states to play their part in adjustment. The US Executive Director said nothing. Unusually, the Board met for a second time that day. Schweitzer said the FRG did not want to float, but might be forced to do so. The Dutch said they would probably follow the FRG's lead.

German complaints shifted to the BIS central bank governors' meeting in Basel on 9 May. Otmar Emminger, Bundesbank vice-president, complained about dollar inflows, stating the FRG had taken in \$8.8 bn in the 15 months to March 1971 and \$3 bn since then. This had "wrecked" the FRG's anti-inflation policy. The FRG would therefore float the mark when it reopened its foreign exchange market in an attempt to create uncertainty for speculators, not to set a new exchange rate.¹¹⁶

FRG Chancellor Brandt wrote to Nixon on 12 May.¹¹⁷ He blamed the US for the foreign exchange crisis "creating great difficulties for the Federal

¹¹⁴ Bank of England archive file OV/53/41.

¹¹⁵ The Swiss, Dutch, Belgians and Austrians had also closed their foreign exchange markets under the weight of a torrent of dollars. France, protected by strong capital controls, had no need.

¹¹⁶ A Bank of England note of the BIS meeting records Emminger's remarks: Bank of England archive file OV/53/41. The FRG foreign exchange market re-opened on 10 May.

¹¹⁷ Brandt called on Nixon on 15 June (Duncombe, Foreign economic policy, 433).

Government”, and disrupting EEC plans for monetary union. He gave Nixon early warning he would raise this with him when next in Washington.

Markets calmed in late May, but Emminger kept up the pressure on the US when he spoke at the American Banking Association’s prestigious annual International Banking Conference, held in Munich, 25-28 May. Connally, Volcker and Burns attended. Emminger described May’s events as “not an ordinary exchange rate crisis, but a crisis of the dollar”.¹¹⁸ With German officials’ feelings bruised by May’s crisis, now was surely the time for the American speakers to mollify their hosts. Burns’ speech adopted a calming tone, although he did include warnings the US’ allies should to make “a significantly larger contribution to the defence of the free world” and “some countries” should relax their import restrictions.¹¹⁹

While Burns was “on message” and soothing, Connally’s conference-closing speech was deliberately abrasive. It was the first time Europeans had encountered, full-frontal, the Nixon administration’s recently adopted neomercantilism. Connally flagged up US concerns about market access for US exporters, military burden sharing and the need for greater exchange rate flexibility. But he was categorical that flexibility would not apply to the dollar, ruling out both dollar depreciation and devaluation. Connally stated it was time for other states to adjust their economies and contribute more:

“No longer can considerations of friendship, or need, or capacity justify the United States carrying so heavy a share of the common burdens ... no longer will the American people permit their government to engage in international actions in which the true long-run interests of the U.S. are not just as clearly recognized as those of the nations with which we deal ... increased cooperation among us all must play a key role in maintaining a stable monetary system”.¹²⁰

Connally returned to Washington to find domestic political pressures on the administration about international monetary affairs were starting to build.

¹¹⁸ Emminger’s 25 May 1971 speech is summarised in a Note for File” in Bank of England archive file OV/53/41.

¹¹⁹ Remarks of Arthur F. Burns, *Two Key Issues of Monetary Policy*; delivered 28 May to the 1971 International Banking Conference, Munich. Source: PDF downloaded from the Fraser Federal Research Archive (<http://fraser.stlouisfed.org/publication/?pid=449>).

¹²⁰ Duncombe, *Foreign economic policy*, 433

Attitudes were confused in Congress and on Wall Street, however, and members of the Foreign Economic Policy Executive were unsure how to interpret the messages they were getting. Congressman Reuss was chairman of the Subcommittee on International Exchange and Payments of the Joint Economic Committee, and a respected expert on international monetary affairs. He introduced a “Sense of Congress” resolution in late June calling for an international monetary conference to be convened immediately. If other states refused, Reuss recommended the US should suspend convertibility and float the dollar. Congress did not adopt his proposal. Wall Street’s and business’ stance on these matters was confused too. McCracken claimed neither US businessmen nor bankers wanted the dollar to float or to see direct controls intensified.¹²¹ Stein, a fellow economist in the Council of Economic Advisers, took the opposite view, at least with respect to bankers. Stein assessed their opinion was shifting in favour of floating the dollar.¹²²

The confusion extended to the administration’s economic policy. Connally mounted a vigorous defence of Treasury primacy in economic and international monetary affairs against McCracken’s and Peterson’s bureaucratic trespasses. Nixon placated him, designating Connally the administration’s leading economic spokesman, the “one voice” on economic affairs.¹²³ Connally thus found himself declaring on 29 June the administrations’ continued adherence to McCracken’s “gradualist” policies in his “four no’s” economic policy announcement.¹²⁴ This policy contradicted the main elements of the

¹²¹ “If we allow things to drift further we may well wind up with more extensive use of direct controls, which would be highly burdensome to our trade and investment interests. Our businessmen and bankers also appear to be generally opposed to wider use of floating rates.” Unclassified Memorandum from the Chairman of the Council of Economic Advisers, McCracken, to President Nixon, 2 June 1971 (Duncombe, Foreign economic policy, 438) “Direct controls” was a reference to capital controls.

¹²² “The attitude of the banking community had changed considerably (by 1970-71) and had become much more receptive to variable rates. This was in part a concession to the intellectual arguments (in academia). But it was also a reflection of the experience with what government actually did in an effort to defend the exchange rate. Specifically the government was limiting the outflow of capital with a tax on interest earned abroad and by ceilings on foreign lending by (US) banks. In other words, the Wall Street financial community was bearing part of the burden of maintaining fixed exchange rates. This did much to convince the conventional conservatives (in the financial community) of the virtues of free exchange rates” (Stein, *Presidential economics*, 165).

¹²³ See Nixon, *Memoirs*, 517, and Haldeman, *Diaries*, 290

¹²⁴ Nixon approved what became known as the “four no’s” policy following his 1971 mid-year review of the economy and budget on 26 June. Connally announced the policy publicly on 29 June, saying the President had concluded “that No. 1, he is not going to initiate a wage-price board; No. 2, he is not going to impose mandatory price and wage controls; No. 3, he is not

“New Economic Policy” Connally and Volcker were developing but was not yet ready to put to Nixon. The abrupt, early reversal of the administration’s “four no’s” domestic economic policy when the New Economic Policy was announced less than two months later added to its shock value on 15 August.

Nixon delivered his first shock on 15 July when he unexpectedly announced publicly his plans to visit China in 1972. Nixon, briefing Congressional leaders on his diplomatic coup, was astonished to find its impact limited. Congressmen were more concerned with US inflation and unemployment. Expressing his surprise to Connally, the latter warned “If we don’t propose a responsible new (economic) programme, Congress will have an irresponsible one on your desk within a month”.¹²⁵ Nixon agreed and instructed Connally to prepare it. Nixon’s endorsement enabled Connally to put the finishing touches to his and Volcker’s planned “New Economic Policy”.

It was Nixon’s turn to be shocked when Connally told the president and Shultz of his proposed “big play” economic policy U-turn when they met on 2 August. Nixon’s agreement to most of Connally’s proposals was a “momentous decision” and “a huge economic breakthrough based on the international monetary situation” according to Haldeman.¹²⁶ Nixon told Connally to refine some of his proposals and obtain Burns’ and Shultz’s approval. Nixon had been taken aback by Connally’s boldness. He was playing for time by refusing to set firm deadlines for publicly announcing the new economic programme.

Markets soon forced the president’s hand. A new foreign exchange market crisis broke in the wake of the poor US foreign trade results.¹²⁷ Market worries intensified when Congressman Reuss published his Subcommittee’s report on the dollar on 6 August. Reuss announced they believed the dollar to be overvalued and the US should suspend gold convertibility unless exchange rates were realigned promptly.¹²⁸ France reacted two days later, announcing its intention to buy \$191 m of gold from the US.¹²⁹

going to ask Congress for any tax relief; and No. 4, he is not going to increase Federal spending”. Connally’s comments are quoted by Matusow, *Nixon’s economy*, 107.

¹²⁵ Nixon, *Memoirs*, 518

¹²⁶ Haldeman, *Diaries*, 335

¹²⁷ The results were published 28 July 1971. They showed the US in deficit on its foreign trade and heading for its first annual trade deficit of the century.

¹²⁸ *Action Now to Strengthen the US Dollar*; see Matusow, *Nixon’s economy*, 147.

¹²⁹ Solomon, *International monetary system*, 184

With foreign exchange markets dumping dollars - foreign central banks absorbed \$3.7 bn in the week 9-13 August - Connally appeared to take Volcker's earlier tactical advice to heart.¹³⁰ He went on holiday to Texas and left the foreign exchange crisis to build. Anxious telephone calls from Volcker and Nixon soon recalled him. The last straw for Washington was a British request for the US to "cover" (guarantee) the entire value of Britain's dollar reserves, \$3 bn.¹³¹ Whereas some central banks had nibbled at the US' gold reserves in May, the US Treasury feared the British move risked precipitating the dreaded run on the gold reserves.¹³² Gold convertibility's time was up.

Nixon convened a secret meeting of his main economic advisers at Camp David over the weekend of 13-15 August. Ostensibly its purpose was to finalise the New Economic Policy package. As Nixon had decided already on the composition of his New Economic Policy in a meeting with Connally and Shultz on 12 August, and had decided the date of its announcement, it is probable Nixon's real intention for the Camp David weekend was to create a sense of unity and collective purpose around the policy.¹³³ Nixon wanted to ensure all available members of his Foreign Economic Policy Executive had irrevocably committed themselves - had "dipped their hands in blood" - by collectively approving the package, especially Burns.¹³⁴ Burns' opposition to closing the gold window was well-known and his relations with Nixon had come close to breaking point in July over unfounded public financial allegations by

¹³⁰ Matusow, Nixon's economy, 147

¹³¹ The British request for "cover" was a request for a "maintenance of value" guarantee in the event of devaluation of the national currency, a routine request between central banks. In this instance the US agreed to cover \$750m of Britain's dollar reserves.

¹³² Belgium, the Netherlands and France had converted \$422m of dollars to gold in the first week of May 1971 (Silber, Volcker, 362n19). The US had also released a similar amount of gold to the IMF for its operations during the course of the year. Connally believed all participants in the 13-15 August Camp David meeting "understood that we were seeing the beginning of a run on the bank" (Connally and Herkowitz, *In history's shadow*, 238).

¹³³ The White House tapes reveal Nixon met Connally and Shultz on Thursday, 12 August to discuss economic policy. They considered various policy elements that might be combined to create the New Economic Policy package, including fiscal measures, a wage-price freeze, import surcharges and closing the gold window. They also discussed when the package might be announced. Nixon concluded: "I think we ought to go Monday with the whole ball." (Brinkley and Nichet, *Nixon tapes*, 233-26) It could be argued, therefore, that the only thing the Camp David weekend changed was the date of the policy announcement, which was switched to Sunday evening instead of Monday in an attempt to publicise the change in economic policy before Japan's financial markets opened. In fact the Camp David meeting participants miscalculated: Japan's markets had opened already when Nixon made his broadcast.

¹³⁴ Kissinger was the only member of the Foreign Economic Policy Executive absent from the Camp David weekend. He needed to travel to Paris that weekend to continue secret peace negotiations with the North Vietnamese government. Nixon, ever distrustful of Foggy Bottom, did not invite any participant from the State Department to fill Kissinger's place.

White House staff.¹³⁵ Nixon knew Burns had to be brought on board lest he use the Federal Reserve's constitutional independence as his soapbox to undermine Congressional and public confidence in the New Economic Policy.

Nixon himself had lingering doubts about closing the gold window and ensured the issue received a full airing. Burns was given every chance to make his case for excluding suspension of gold convertibility, both in general discussion on the first afternoon of the Camp David meeting, and in a private discussion with Nixon that evening. Burns recorded in his diary "this subject was discussed more extensively than any other".¹³⁶ Ehrlichman's handwritten meeting notes and Safire's vivid, sometimes verbatim, record of the first afternoon's discussion on 13 August confirm Burns was in a minority of one, and by the following day was fully committed to the whole package.¹³⁷

Burns had framed his argument in terms liberal theorists would understand: co-operation within the Bretton Woods regime was good for the US and, if the US were to scrap gold convertibility unilaterally, the US would face damaging and unmanageable consequences, including protectionist controls on trade and payments. Implicitly, Burns did not believe the US had the structural power to control other states' reactions to it closing the gold window and imposing a 10% surcharge on US imports. In his view, adopting a neomercantilist policy in search of relative gains for the US would be counter-productive, possibly leading to "chaotic financial markets... followed by trade wars, currency wars and political frictions - as occurred in the thirties".¹³⁸

Connally took the opposite view: the US did not have the power to sustain a co-operative approach any longer under Bretton Woods' rules: it lacked the necessary gold reserves and "anybody can topple us, anytime they want".¹³⁹ The status quo would leave the US unacceptably vulnerable to other states withdrawing their co-operation and initiating a run on gold. If the US neutralised that issue through unilateral action, Connally believed, the promise of eventual restoration of convertibility and/or of abolition of the 10% import surcharge would force the US' allies and trading partners to making significant

¹³⁵ Outlined in chapter 3

¹³⁶ Burns and Ferrell, Secret diary, 52

¹³⁷ Ehrlichman's notes can be found in Kesaris, *Papers of the Nixon White House*. Safire, Before the fall, 509-21 provides an eye-witness report of the meeting.

¹³⁸ Burns and Ferrell, Secret diary, 52

¹³⁹ Safire, Before the fall, 514

and overdue concessions on international monetary reform, trade liberalisation and burden-sharing. Moreover, unilateral action taken now would enable Nixon to continue to provide the international leadership US voters expected of their president. Connally knew the US would need to use its structural power to gain its objectives - relative economic gains for the US and new rules of the game for the international monetary system - and he persuaded Camp David participants they should support dramatic action.¹⁴⁰

Those present agreed a comprehensive economic package that included new tax breaks, public spending cuts, a 90 day freeze on wages and prices, suspension of gold convertibility and a 10% import surcharge.¹⁴¹ Nixon announced it on television on 15 August 1971.¹⁴² The package was intended to boost US output and employment and reduce inflation, at least temporarily, while liberating the US balance of payments from the “strain” of gold convertibility. The package would also create an opportunity to shift some US hegemonic costs to allies and trading partners. But what was not agreed - because it was never discussed at Camp David - was how long the international

¹⁴⁰ Indicating his awareness that the Camp David decision marked the use of structural, not simply relational power, Connally later wrote: “...the decisions taken at Camp David not only changed the game plan, they changed the rules of the game...we thought the rules might have been changed forever” (Connally and Herkowitz, *In history's shadow*, 241).

¹⁴¹ The New Economic Policy (this term was dropped as soon as the administration realised it replicated the name Lenin gave his economic policy) comprised ten measures: a new investment tax credit was created at a rate of 10% in the first year (5% thereafter) for US businesses that bought American-made machinery and equipment or built new plant in the US; the 7% excise tax on automobile purchases was repealed; a \$50 personal tax cut was brought forward from January 1973 to January 1972; federal employee numbers were to be reduced by 5% and their pay increases postponed; welfare reforms were postponed by a year and new welfare funding arrangements were delayed; prices, wages and rents were to be frozen for three months; a Cost of Living Council would be created to ensure price stability was maintained after the freeze ended; foreign aid was cut 10%; dollar convertibility into gold was suspended; and a temporary 10% import surcharge was imposed.

¹⁴² *The Challenge of Peace*, an address to the nation outlining a New Economic Policy, 15 August 1971 (see Nixon, *Public papers*, 1971).

Nixon was clear about his objectives: “Prosperity without war requires action on three fronts: we must create more and better jobs; we must stop the rise in the cost of living; we must protect the dollar from international money speculators.”

Nixon was also clear about his tactics: “The import tax is a temporary solution. It isn't directed against any other country. It is an action to make certain that American products will not be at a disadvantage because of unfair exchange rates. When the unfair trade treatment is ended, the import tax will end as well.

“As a result of these actions, the product of American labour will be more competitive, and the unfair edge that some of our foreign competition has will be removed. This is a major reason why our trade balance has eroded over the last 15 years.

After discussing post-war economic recovery in Europe and Asia, Nixon added “... now that other nations are economically strong, the time has come for them to bear their fair share of defending freedom around the world. The time has come for exchange rates to be set straight and the major nations to compete as equals. No longer will the United States compete with one hand tied behind her back.”

measures should remain in place, nor what these policies meant for the long-term health of the international monetary system.¹⁴³ Indeed, there appears to have been little concern that, in adopting a Realist and relative gains perspective on international monetary issues in pursuit of domestic political and economic objectives, the US had prioritised domestic objectives over sustaining the Bretton Woods regime. That fact would become clearer over the coming months as Connally's perceptions of US structural power met the reality of its inadequacies in the face of determined European and Japanese resistance.

Nixon's Camp David meeting had been held in total secrecy. Allies had not been consulted. Neither international co-operation nor dialogue had been sought. Confrontation and domination, not hegemony by consent, was Connally's way. Nixon had decided to give him his head: the State Department was not represented at Camp David; Kissinger was elsewhere. Connally believed the US, working patiently in tandem with powerful, speculative pressures from foreign exchange markets, could grind down allies' and trading partners' opposition. Confronted with US obduracy, they would have to adjust their economies to eliminate the US' current account deficit, or they would have to finance it by taking ever more dollars into their reserves. "It's our currency but your problem" summed up his domineering approach to imposing new exchange rate, trade and burden-sharing arrangements on allies.

Conclusions

The Bretton Woods regime, dogged by its flawed assumptions and design, was in poor shape when Nixon took office. But its condition was not terminal.¹⁴⁴ Effort was required to kill it.

¹⁴³ Burns recalled "Nixon feared that leaving the gold window open and realigning exchange rates may work for a time, but risked blowing up again and disrupting the Presidential election. He preferred to take the hard decisions early - and the hard criticism - and reap the harvest of approval later. All this seemed to assume - though nothing was said to this effect - that the dollar would be allowed to float until after the (Presidential) election. When I later pointed this out to Volcker, he was truly frightened." (Burns and Ferrell, Secret diary, 52)

¹⁴⁴ Volcker, having argued the US hegemon had sustained the Bretton Woods regime for more than twenty years, commented: "I am ready to accept intellectually that, given enough time, any hegemon will become either tyrannical or just plain fat and sloppy. But ... I was not prepared then to accept passively that breakdown would be inevitable within a single generation, nor do I believe that today" (Volcker and Gyohten, Changing fortunes, 63).

The US solved Bretton Woods' liquidity problems by creating an international consensus in 1969. That was necessary for Bretton Woods' survival, but not sufficient. Sufficiency required it to have a viable adjustment system. Creating this was beyond the US' capabilities when using hegemony by consensus tactics. The US would not adjust its economic policies; other states would not accept more flexible exchange rate arrangements. Both the US and Europe wanted a co-operative solution, but neither was willing to sacrifice their immediate interests to break the deadlock.

The regime was brought down eventually by an economic policy pincer movement from the US: Burns' recklessly expansionary monetary policy; and Nixon and Connally adopting neomercantilist external policies in pursuit of the ideal electoral climate for the 1972 presidential election. Both policies marked a US retreat from its international responsibilities. The US was not alone in this, however, as was demonstrated by European states' refusal to contemplate improvements to the Bretton Woods' failing adjustment mechanism.

When hegemony by consent failed to deliver for the US, it switched to hegemony by domination tactics, unilaterally suspending gold convertibility and imposing a 10% import surcharge. It threatening to maintain these policies until Europe and Japan bowed to its will.

The Foreign Economic Policy Executive played a full role in these events. Initially it united behind a policy of prioritising dealing with the international pressures ahead of US domestic political concerns, tackling the international imperatives by seeking an international consensus on Bretton Woods reform. When consensus proved elusive and a lingering US recession threatened Nixon's re-election prospects, the Foreign Economic Policy Executive split. Nixon and Burns were the first to prioritise domestic political objectives. Shultz and Connolly, and later Volcker and McCracken followed as all members present at Camp David re-united behind the neomercantilist New Economic Policy. The absent Kissinger's crucial role would emerge later.

Chapter 5

The Smithsonian Agreement: Cutting the Deal

“Mr. Connally said that he would himself have preferred to allow the dollar to float at least for six months from August, but was persuaded to work towards an earlier settlement by pressure from other countries.”¹

“What we really did not want, and really had forced upon us, was a change in the official price of gold that a succession of administrations had pledged was inviolate.”

(Paul Volcker²)

This chapter, covering developments in August-December 1971, continues my examination of how the US attempted to use economic crises to strengthen its relative power and hegemony, in this case a crisis the US had engineered by suspending gold convertibility and the Bretton Woods regime's operations. As in chapter 4, I build my argument using the concepts, definitions and theoretical framework discussed in chapters 1-3.

Suspending convertibility was an act of hegemonic domination achieved using negative structural power. The Foreign Economic Policy Executive had agreed to gamble on forcing the US' follower states into offering trade policy, exchange rate and defence burden-sharing concessions. Its decision to prioritise domestic political objectives over the international imperative of adherence to the Bretton Woods regime's rules was popular in the US.³ The odds on the policy's international success also looked good. Suspending convertibility had side-lined the IMF. Henceforth, balance of payments

¹ Excerpt from the British record of the Nixon-Heath summit, at the Princess hotel, Bermuda, 20 December 1971. (Source: Bank of England archive file OV53/42)

² Volcker and Gyohten, *Changing fortunes*, 81

³ The US public and stock market were delighted by Nixon's actions: his approval rating soared to 73%, overtaking his rivals for the 1972 presidential election. The New York stock exchange achieved a then-record one-day increase in the Dow Jones Index on 16 August (Small, *Presidency of Richard Nixon*, 209).

adjustment would be determined not by rules, but by power, and the US was the most powerful state. Nixon did not want a balance of payments improvement through US adjustment: that risked increased unemployment ahead of the 1972 presidential elections. He wanted the rest of the world to adjust to US requirements. He wanted other states to liberalise their trade policies even as he set the US on a protectionist course. He wanted others to make the US economy more competitive by appreciating their currencies against the dollar. And he wanted them to pay more for their defence, releasing US resources he could use to boost US employment and create grateful voters.

This chapter analyses why hegemonic domination was only partially successful for the US, despite convertibility's suspension enhancing the US' already preponderant economic power by replacing the gold exchange standard with a pure dollar standard. I argue the US lacked the positive structural power needed to achieve its objectives in the face of external opposition, led by France, and internal opposition, led by Burns and taken up by Kissinger and McCracken within the Foreign Economic Policy Executive. They ensured Nixon shelved hegemonic domination and returned to hegemony by consent, a tactical shift that led to the Smithsonian agreement. I argue attempted domination undermined allies' support, weakening US legitimacy and hegemony. Resumption of hegemony by consent appeared to restore US relations with its partners to an even keel. But the Smithsonian proved to be a truce, not a resolution of tensions between the US and its allies.⁴

The chapter is organised into six sections: international relations theory's predictions; Connally's strategy; procrastination; foreign opposition; domestic opposition; the resumption of co-operation; and conclusions.

International Relations Theory's Predictions

Nixon's decision to close the gold window would be a turning point for the international monetary order, but in which direction? Liberal, Marxist and Realist theorists produced competing perspectives.

⁴ Strange described the Smithsonian agreement as "a ceasefire, not a peace treaty" (Strange and Prout, *International monetary relations*, 345).

Liberals saw August's events as marking a crisis in international co-operation. Closing the gold window violated the norms and principles the Bretton Woods regime was supposed to uphold. Offenders were supposed to be punished for regime breaches, implying Washington would have to make a tangible contribution towards any replacement regime. Liberals expected the replacement regime would need to cope with post-1945 structural changes as well as relieving the US of some regime-maintenance costs.⁵

Marxist analysts believed Nixon's announcement signalled profound problems in US capitalism, reflecting a low rate of profit. Measures to raise it would include: dollar devaluation (or competitors' currency appreciation); opening foreign markets to US exports; transferring some US military costs to allies to facilitate lower taxes on US capitalists; and creating new opportunities for outward foreign direct investment from the US, enabling US employers to tame their workers' wage demands by threatening to export their jobs.⁶

Realists saw matters in similar terms to Marxists, minus the class element. Gilpin interpreted Nixon's 15 August announcement as supplementing the new "Nixon Doctrine"; he expected Nixon to pursue relative economic gains by adopting neomercantilist trade and exchange rate policies (even at the risk of creating new currency and trade blocs) and shedding some US military costs to allies.⁷ This would reinforce the US's ability to lead the Western alliance in

⁵ There were three main structural changes: economic recoveries in Europe and Japan had redistributed economic power in their favour and away from the US; there had been a deconcentration of gold reserves away from the US towards Europe; and participants in the Eurodollar market had emerged as powerful actors in foreign exchange and capital markets.

Liberal economist Fred Bergsten encapsulated the "generic" liberal view in a *Foreign Affairs* article commenting on the New Economic Policy (Bergsten, "New Economics", 199-222). It was written shortly after Nixon had announced his New Economic Policy and only months after Bergsten had resigned from the National Security Council staff in May 1971, where he had served as Kissinger's economic adviser. See also Cooper, "Trade policy", 29-36, Oppenheimer's contribution to Cooper et al, "Future of the dollar", 23-28, and Vernon, "Balance of payments", 52-65, for a flavour of Liberal thinking at the time.

⁶ This summarises policy recommendations put forward by Panitch and Gindin, Gowan, and various World System theorists as discussed in chapter 2.

⁷ See Gilpin, "Three models of the future", 57; and his, *War and change*, 186-93.

Nixon wanted to discourage both US over-stretch and US follower states from becoming over-dependent on their hegemon for their security. He elaborated the "Nixon Doctrine" to limit the US' post-Vietnam security commitments, first set out in a media briefing on Guam (25 July 1969) and subsequently refined in a speech given in Vietnam (3 November 1969). The Doctrine comprised three elements: "the US will keep all its treaty commitments; the US will provide a shield if a nuclear power threatens the freedom of a nation allied to the US, or of a nation whose survival the US considers vital to US security and the security of the region as a whole; and, in cases involving other types of aggression, the US will furnish military and economic assistance when requested and as appropriate. But the US will look to the nation

balancing against the USSR. There were alternative Realist views. Brzezinski downplayed Nixon's economic motives and expected him to gain power by trading unimportant economic concessions to allies for important gains on security.⁸ Strange also saw Nixon's move as a power play, claiming the US had selfishly flooded the world with dollars in order to replace the Bretton Woods regime with something better suited its interests.⁹ She disputed Liberal and Marxist claims of US weakness causing Bretton Woods' collapse.¹⁰

In retrospect, it is unclear which of the rival theorists would have provided the best steer for policy makers. Each pointed to aspects, but not the entirety, of the eventual outcome. Liberals were right: the US and its partners tried to restore co-operation by reforming Bretton Woods, but achieved less than they had hoped; reduced co-operation proved costly.¹¹ Marxists were right: the US obtained an exchange rate realignment that redistributed profit in its capitalists' favour; moreover, the US adopted new policies that liberalised international trade and capital flows, facilitating increased US goods and capital exports. And Realists were right: the US achieved relative gains by depreciating the dollar, obtaining better burden-sharing arrangements, removing other states' trade barriers (over time) and reforming the international monetary system.

With theoretical guidance ambiguous, how did unguided policymakers set about their tasks?

Connally's Strategy

Nixon sent confidential telegrams to the main Western leaders informing them of his New Economic Policy on 16 August and requested their co-operation: "What we need now is an early agreement on improvements in the

directly threatened to assume the primary responsibility of providing the manpower for its defence" (Kissinger, *White House years*, 224-25).

⁸ Brzezinski, "Half past Nixon", 11

⁹ Strange, *Casino capitalism*. See also Strange, "Dollar crisis", and Strange and Prout, *International monetary relations*, for her dismissal of the importance of regimes.

¹⁰ For example, hegemonic stability theorists, such as Kindleberger in his *World in depression*, liberals who shared similar views, such as Keohane, in *After hegemony*, and World System theorists who estimated the US' problems (Vietnam, Bretton Woods and OPEC) signalled a change in the US hegemonic cycle's direction from upswing to downturn.

¹¹ The US and most other industrial countries experienced a decade of stagflation - high inflation combined with low or nil economic growth - in the 1970s.

international monetary and trading system".¹² Connally immediately set out to achieve the opposite. His aim was to delay any agreement by at least six months, and possibly until after the presidential elections in November 1972, as Burns soon spotted.¹³

Connally knew the Camp David decision had created a high stakes game: "... what was at stake was nothing less than the American role in a stable international society."¹⁴ Although often reluctant to share details and specifics with colleagues, Connally knew what he wanted to achieve and had a strategy for delivering it.¹⁵ He believed the non-communist world craved US leadership.¹⁶ His vision, articulated in a secret meeting with Japanese Prime Minister Sato on 12 November 1971, was of the US providing this leadership from a position of strength. Connally explained to Sato the US had adopted the New Economic Policy "to prevent any decline in our ability to maintain adequate military strength, to ensure economic security, and to avoid the destruction of our ability to maintain economic assistance programmes... The President is now able to reduce tensions with the USSR and China because he is dealing from strength..."¹⁷

Nixon shared this vision.¹⁸ He delegated the task of achieving it in the international monetary arena to Connally. August's Camp David discussion did

¹² Duncombe, Foreign economic policy, 468-69

¹³ Burns assessed Nixon's decisions at Camp David were driven by fear of another foreign exchange market crisis and a run on US gold reserves blowing up during - and wrecking - his 1972 presidential re-election campaign, hence the decision to suspend gold convertibility before this could occur. "All this seemed to assume - though nothing was said to this effect - that the dollar would be allowed to float until after the election. When I later pointed this out to Volcker, he became truly frightened." (Burns and Ferrell, Secret diary, 52) Volcker had imagined the period of floating would last no more than two months: "I thought we could wrap up an exchange rate realignment and start talking about reform in a month or two, say by the IMF (Governors' Annual) Meeting in late September. Instead I got a fast lesson in big-league negotiation" (Volcker and Gyohten, Changing fortunes, 80).

¹⁴ Connally and Herkowitz, In history's shadow, 236-37

¹⁵ Volcker recalled: "sometimes (Connally) played his cards so close to the vest that I did not know what he really wanted." (Volcker and Gyohten, Changing fortunes, 98)

¹⁶ Connally set out his leadership "vision" in a seminar at the American Enterprise Institute in 1978: "The world is looking for the United States to assert its leadership. It does not require much travel around the world to realise the incredible dependence that the world feels towards the United States in terms of its leadership. If the Free World has a leader, it is the United States and if we falter or we fail, then every nation in the world that aspires to any degree of freedom will feel that it has been cut adrift, that it has no hope of help" (Connally, Conversation, 25).

¹⁷ Secret Memorandum of Conversation, Connally/Sato, 12 November 1971; Duncombe, Foreign economic policy, 538-43

¹⁸ Speaking at a press conference on 16 September 1971, Nixon said "...a weak America will inevitably be isolationist. An America that is unable to maintain its military strength - and incidentally in the whole Free World the United States pays two thirds of the military bill

not constrain Connally: it had barely touched on longer term issues.¹⁹ Nor did Nixon restrict Connally by giving the Foreign Economic Policy Executive specific guidance on the matter.²⁰

Connally set himself some specific delivery objectives:

- no dollar devaluation;²¹
- a \$13bn US current account improvement, mainly at the expense of other OECD member states;²²
- achieve this by reducing other G10 states' barriers to US exports, obtaining "better" burden sharing arrangements for US military costs

today - a weak America that is unable to have its economic programmes abroad, our economic and foreign aid programmes, the rest, inevitably will withdraw into itself. We have to have a strong America, strong economically and strong in the sense of its competitive spirit if the United States is to continue to play a vigorous, activist role in the world" (quoted in Johnson, Nixon presidential press conferences, 208).

¹⁹ Stein admitted ruefully: "This suspension of realism (at Camp David) enabled the participants to overlook a number of questions that would have been considered at length if the decisions had been made in a less exotic environment... (T)here was no agreement on what was to happen next. There were two possibilities. One was that the exchange rate of the dollar would decline and find a new level, which we would try to maintain. If this was the course, the question of the desirable new level of the dollar had to be faced. The other possibility would be that the dollar would float... Little consideration was given at Camp David to either alternative" (Stein, *Presidential economics*, 177-78). Stein also revealed that, although monetary policy would have a major impact on the New Economic Policy, this was not discussed either (*Ibid.*, 178). Nonetheless, participants returned to Washington "in a state of exhilaration", feeling they had accomplished a great deal in 48 hours (*Ibid.*, 179). Volcker left Camp David wishing they had accomplished more by concluding agreements on the administration's policies towards gold and international monetary system reforms; Volcker commented acidly that Nixon was less concerned with gold than with implementing a campaign pledge to protect US textile manufacturers (Volcker and Gyohten, *Changing fortunes*, 79).

²⁰ Volcker recalled "Nixon, like other presidents, resented the idea that his freedom of action might be limited by monetary difficulties. The only objective I heard him state about a reformed monetary system, and I heard him say it more than once, was that he didn't want 'any more crises'. That made me distinctly uneasy. I didn't know how to design a system that would be guaranteed against crises, irrespective of our domestic policies" (*Ibid.*, 104).

²¹ This objective was set out in a confidential Treasury brief, *US Negotiating Position on Gold: The official dollar gold price would not change*, prepared on 9 May 1971 (Duncombe, *Foreign economic policy*, 427-31). Connally apparently drew on it when he stated the US' "unalterable position" was that "we are not going to devalue, we are not going to change the price of gold" in his closing speech to the American Banking Association's annual International Banking Conference in Munich on 28 May 1971 (quoted in Volcker and Gyohten, *Changing fortunes*, 75). Nixon confirmed the "no devaluation" policy on several occasions.

²² Volcker informed other G10 states of this US objective at a G10 Deputy Finance Ministers' meeting in Paris on 2-4 September. Volcker explained to his "appalled" counterparts the US needed this big swing in its current account over the next twelve months (largely at their expense) because the US current account was heading for a deficit of \$4bn in 1971; a further \$6bn was required to cover the cost of US capital exports; the residual \$3bn was needed to enable the US to end its remaining "special controls and restraints on foreign payments" and run a small surplus for a time to reduce US net liabilities to foreigners (*Ibid.*, 81).

abroad and depreciating the dollar against other G10 currencies by a trade-weighted average 15%;²³ and,

- international monetary reforms, including symmetry in creditor and debtor states' adjustment responsibilities and greater flexibility in the adjustment process through introducing wider exchange rate bands around par values and/or new mechanisms for adjusting parities frequently by small amounts.²⁴

Connally, famously "political to his fingertips", prioritised the objective most likely to win votes in the 1972 presidential elections: trade gains to boost US jobs and living standards. Connally wanted to improve US competitiveness through dollar depreciation and liberalise other states' trade policies to increase US exporters' market access. Using Peterson's rule of thumb, improving the current account by \$13 bn. primarily through trade would create some 1.4 million jobs, taking approximately 1½ percentage points off the unemployment rate.²⁵ Politically, this was irresistible for Connally and Nixon.

Avoiding devaluation was another political priority. Connally ruled out devaluation because it would be problematic politically: it would undermine US prestige internationally and Nixon's reputation at home; moreover, securing devaluation might be politically difficult because Congressional approval was required - always a hostage to fortune. In any event, Nixon did not want to be known as the first president to devalue the dollar since 1934.

Burden-sharing, a "nickels and dimes" element in Connally's objectives, offered few economic gains or votes. But progress on it would take some

²³ Peterson's analysis of other states' protectionist policies in *The United States in a Changing World Economy* (discussed in chapter 4) provided the administration with a hit list, at the head of which was the EEC's Common Agricultural Policy. Other trade priorities were never articulated clearly or consistently. What constituted "better" burden-sharing was never definitively agreed. The depreciation target was based on calculations produced by a senior economist in the Treasury, John Auten, in early 1971 at Volcker's request. Auten calculated the dollar was overvalued by 10-15% (Ibid., 72). Connally and Volcker decided to seek a 15% depreciation of the dollar relative to its value against other G10 currencies in May 1971 and pursued this in negotiations in G10 Ministerial and Deputies meetings throughout autumn 1971.

²⁴ As outlined in the contingency plan Volcker put to Connally in May 1971: the confidential Treasury document "Contingency" of 8 May 1971 (Duncombe, Foreign economic policy, 423-27). Connally drew heavily on Volcker's plan when briefing Nixon on the need for action on convertibility on 2 August 1971 (see chapter 4).

²⁵ US unemployment was 6% in summer 1971. Peterson calculated the Smithsonian agreement would achieve only half of Connally's target of \$13bn current account gains; nonetheless it would generate 700,000 additional jobs and reduce the unemployment rate by 0.8% (Matusow, Nixon's economy, 178). My estimates above - which should be viewed as orders of magnitude only - simply double Peterson's to illustrate what the Nixon administration might have felt was at stake had the US achieved its current account objective in full.

pressure off the US balance of payments and the issue was useful for bargaining purposes, especially with the FRG and Japan.²⁶ Connally, with some justification, highlighted the threat to defence spending in Europe and Japan posed by the “troops out” Congressional contingent led by Senate leader Mike Mansfield.²⁷ They wanted to save money by bringing US forces home and achieved occasional successes.²⁸ Nixon’s force reductions in Vietnam added credibility to US burden sharing-demands.

International monetary reform was Connally’s lowest priority. It offered no prospect of gaining votes ahead of the 1972 elections: the issue did not interest voters and there was no international consensus favouring an early reform agreement. Nixon, despite being “elated” and “euphoric” about the domestic delight and foreign condemnation that greeted his New Economic Policy, quickly lost interest in reform.²⁹ Connally instructed Volcker not to develop international monetary reform plans.³⁰ US foot-dragging was evident when British Chancellor Barber hosted a bilateral meeting with Connally and

²⁶ “I thought we had a right to expect, and even demand, fairer trade arrangements and more help from our allies in bearing the cost of their defence...” (Connally and Herkowitz, In history’s shadow, 240).

²⁷ See, for example, the record of Connally’s meeting with FRG Finance minister Schiller in the margins of the IMF Annual Meeting: confidential Memorandum of Conversation, 25 September 1971 (Duncombe, Foreign economic policy, 506-11); and Connally’s secret meeting with Sato: secret Memorandum of Conversation, 12 November 1971 (Ibid., 538-43).

²⁸ Senator Mansfield introduced amendments to the Selective Services Act in May 1971, aiming to reduce US troop numbers in Europe; it was defeated 61-36. But he was successful in the Senate in June when he introduced an amendment requiring withdrawal of all US forces from Vietnam unless North Vietnam released all US prisoners of war; the amendment was passed by the Senate 57-42, but defeated in the House (Black, Richard M. Nixon, 719).

²⁹ Kissinger recalled: “When during the evening of 16 August I returned from Paris to a *fait accompli*, I found Nixon elated. For the second time in a month he had taken the world by stunning surprise; he saw himself revolutionising international finance as he had already transformed international diplomacy. He revelled in the publicity coup he had achieved. As he often did, he asked me innumerable times to recite the foreign reactions, which were mixed at best; he was delighted by the domestic approval... (a) mood of euphoria (prevailed)...” (Kissinger, White House years, 955)

³⁰ Connally told Volcker “a concerted reform effort was premature for the simple reason that an adequate agreement was not possible” (Volcker and Gyohten, Changing fortunes, 115). In January 1972 Volcker commissioned former Treasury Director of the Office of International Affairs, George Willis, to undertake a secret review of all international monetary reform proposals. Willis submitted his written report on 7 August 1972, but kept Volcker abreast of progress in oral briefings, telling him “Absolutely nothin’ will work” (Silber, Volcker, 111). The Federal Reserve was unaware of the Treasury planning for international monetary reform before March 1972 (Solomon, International monetary system, 220). A British official, J. A. Marshall, visited Washington for meetings with officials in the US Treasury, State Department, Federal Reserve, CEA and the Council for International Economic Policy in March 1972. He assessed US economic thinking on reform was “little developed” (Marshall’s back-to-office report of 20 March 1972; Bank of England archive file OV53/42). Connally resigned on 16 May 1972; Shultz replaced him and in June asked Volcker for a brief on the Treasury’s international monetary reform proposals, only to be told “We are not that far along...” (Silber, Volcker, 111).

Volcker in December 1971. Barber suggested the US and UK work bilaterally on reform issues. Connally and Volcker questioned “whether it was worth designing a new long-term system for the G10 when the EEC might in due course move towards a common currency.”³¹

The Camp David discussions revealed Connally was confident he could achieve his objectives using US power.³² He had four specific “leveraging” tools for the purpose: the New Economic Policy’s 10% import surcharge; the “Buy American” provisions in the New Economic Policy’s Investment Tax credit; suspension of gold convertibility; and, foreign exchange market forces. The 10% surcharge damaged states exporting to the US (especially Japan, Germany and Canada); Connally periodically offered to remove it if other states met US demands. “Buy American” incentives damaged export prospects for foreign companies making investment goods, notably the capital goods in which German industries specialised. Like the import surcharge, it could be traded for other states’ concessions. Suspending gold convertibility did not inconvenience states whose policy was to refrain from converting their dollars to gold, notably Japan and the FRG, but the measure vexed francophone countries: they preferred gold to currency reserves. And market forces could be relied upon to put pressure on states with undervalued currencies, appreciating their exchange rates against the dollar unless (like France) they were prepared to use draconian capital controls to block market forces.³³

Connally felt time was on his side. His strategy was to squeeze other states’ export sectors to create unemployment, putting domestic political pressures on foreign governments until they complied with US demands. He calculated the longer his pressures built, the stronger his negotiating position

³¹ British record on UK/US bilateral meeting at the Princess Hotel, Bermuda on 20 December 1971. (Bank of England archive file OV/53/42.)

³² Safire recorded Connally’s response to Burns’ challenge to his proposal to close the gold window, suggesting he felt the US almost invulnerable to other states’ economic power:

“Burns: Yes, this (closing the gold window) is widely expected. But all other countries know that we have never acted against them. The good will...

“Connally: We’ll go broke getting their good will.

“Volcker: I hate to close the gold window. All my life I have defended (fixed) exchange rates, but I think it is needed.

“Burns: They can retaliate.

“Connally: Let ‘em. What can they do?” (Safire, *Before the fall*, 514)

³³ Shultz commented on Connally’s strategy: “US officials had formed an alliance with the market itself to force a change in the behaviour of foreign officials...From a political point of view the import surcharge and the alliance with market forces were strong medicine.” (Shultz and Dam, *Economic policy*, 115),

would become. His strategy had two vulnerabilities. First, other states might have sufficient power to resist the US. As Burns pointed out, they had “pride as well as problems” and could retaliate with new capital controls or trade measures.³⁴ Volcker feared they would introduce their own structural change by forming a European gold-based currency bloc rivalling the dollar.³⁵ Second, the credibility of Connally’s strategy depended on the Foreign Economic Policy Executive supporting his policies: disunity within the Foreign Economic Policy Executive would fatally undermine the strategy. Connally was confident, but not naive. He understood the vulnerabilities and took pains to maintain a show of unity within the Foreign Economic Policy Executive while at the same time offering apparently preferential bilateral deals to other states to split the foreign opposition. He failed on both counts.

US Procrastination

Connolly used stonewalling tactics to buy time for his strategy, including: procrastination - refusing to propose initiatives; misrepresentation - to confuse the opposition; actively blocking others’ attempts at initiating negotiations; and, megaphone diplomacy to bring foreign lobby groups into play on the US’ behalf.

Connally’s main tactic was procrastination: he refused to propose initiatives that might start or advance the negotiating process. US representatives in international monetary meetings persistently claimed it was for others to solve international monetary problems to the US’ satisfaction: the US had no proposals to make. As to what would satisfy Washington, US representatives could not say very much about that either, until Volcker unveiled some US objectives in September 1971. Connally and Volcker claimed their participation in meetings signalled the US’ desire to consult, not negotiate. They refused to table proposals, ostensibly to prevent other states unifying their opposition and blocking otherwise “meritorious” proposals.³⁶ While there may

³⁴ 20 September diary entry recording Burns’ efforts to persuade Nixon that “Connally did not show enough understanding of the position of other countries” (Burns and Ferrell, Secret diary, 52)

³⁵ Discussed in chapter 4

³⁶ Volcker repeats this line in his memoirs as he describes the G10 Deputies’ meeting at Wychwood House on 16 August 1971: “I sensed in their tone they did not feel anger as much as

have been some truth in this, the real reason was Connally's wish to delay any solution. Washington knew EEC states' internal co-ordination procedures were ponderous and was in no hurry for the Europeans to get their act together by giving them something specific to negotiate about.³⁷

Procrastination dominated the US' first contact with other states after 15 August: Volcker's hastily arranged visit to meet European and Japanese Finance Ministry and central bank representatives in London on 16 August.³⁸

anguish that the United States had not arrived with a prepared solution to save the system. That was in part deliberate. We had no solution we thought our partners would yet be prepared to accept." (Volcker and Gyohten, *Changing fortunes*, 81) And when Volcker briefed the US delegation ahead of the IMF/World Bank Annual Meetings in September 1971, a member of the delegation recorded Volcker telling them they would not be making monetary proposals for fear of uniting foreign opposition to "meritorious proposals"; confidential record of Volcker briefing by Agency for International Development official, Lawrence Berlin; Duncombe, *Foreign economic policy*, 504-06).

³⁷ The EEC's agreed negotiating position was not finalised until 4 November 1971.

³⁸ Volcker, accompanied by Federal Reserve Governor Daane, had arrived in London on 16 August as President Nixon's "financial envoy" - as the media dubbed him. He had come for a meeting at Wychwood House, the US ambassador's London residence, to brief his European and Japanese counterparts on the New Economic Policy, and to begin the process of delaying a solution to the international monetary system's problems. The US contribution at this meeting was typical of what followed in G10 Deputy, G10 Ministerial and OECD WP3 meetings in September.

According to the British record of the meeting, Volcker said the US needed to run balance of payments surpluses, ruled out US devaluation against gold and declared "it was now for other countries to consider what programme of measures, including parity changes, would bring about the necessary strengthening of the US payments position... Mr Volcker gave the impression that the Administration would not be dismayed if the situation led to a period of floating by the other major currencies in a way that would allow the market to throw a light on the appropriate parities." Volcker "implied" the surcharge was temporary and could be dropped once the US was satisfied with other states' policy adjustments. Tellingly, the Bank of England's record reveals convertibility was regarded as a secondary problem: "In discussion the main pressures were developed against the bargaining use of the import surcharge." (Bank of England Governor O'Brien forwarded the British record of this meeting to the Governor of the Bank of Portugal on 18 August 1971 in response to the latter's undated request for information on Volcker's meeting with representatives from UK, France, FRG, Italy and Japan; Bank of England archive file 6A 213/1.)

Volcker lifted the veil a little at the OECD WP3 and G10 Deputies meetings in Paris on 2-4 September. He revealed the US current account was headed for a \$4 bn deficit in 1971 and the US wanted a \$13 bn improvement on a sustained basis. This was a huge relative gain, to be achieved largely at the expense of other OECD member states. Volcker's did not reveal the US had calculated it needed a 15% depreciation to underpin these current account ambitions, but his counterparts were horrified by the exchange rate implications nonetheless. Connally did not enlighten his G10 counterparts further at the G10 Ministers and Governors meeting at Lancaster House in London on 15-16 September.

Lancaster House was a fractious meeting. Connally goaded the other states, saying "We were generous in our years of prosperity and now we expect to be generous in sharing our problems. That's what friendships are for." (quoted in Matusow, *Nixon's economy*, 169). Connally refused to share US proposals on how the US might achieve its objectives, other than to emphasise the US would not devalue and other states would have to make the necessary exchange rate adjustments themselves without any devaluation "contribution" from the US. European states and Japan responded by insisting they would not appreciate their currencies unless the US devalued the dollar against gold. But the EEC was split: the FRG favoured fixing EEC states' exchange rates against each other while adopting a common float against the dollar; France, having devalued as recently as 1969, wanted neither an appreciation nor a float.

Remarkably, Connally was still procrastinating on a visit to Tokyo on 12 November, by when the tactic had lost credibility.³⁹

Connally's second tactic, misrepresentation, is revealed in the US official record of Volcker's Wychwood House meeting on 16 August.⁴⁰ A Bank of England participant, Jeremy Morse, asked if the US had a target exchange rate for the dollar. Volcker denied it, although he and Connally were already working on the basis of a 15% dollar depreciation target. Asked about the rapid increase in the US money supply and its relationship with the New Economic Policy, Governor Daane admitted the US money supply had been growing too fast for their liking, but claimed the Federal Reserve was regaining control. In fact Burns was already accommodating Nixon's requests to accelerate money supply growth. Such US misrepresentations became routine in late 1971.

US misrepresentation's main objective was to buy time until market forces had appreciated other currencies (and thus depreciated the dollar) by something close to Connally's 15% target. He needed all the time he could get and deployed a third delaying tactic when necessary: active blocking.⁴¹

Connally and Volcker actively fended off others' attempts to initiate negotiations. On 21 August IMF Managing Director Schweitzer proposed to convene a meeting to discuss exchange rates, the import surcharge, gold and systemic reform; the US Treasury's press spokesman dismissed Schweitzer's proposal as "not productive".⁴² With the IMF's existence seemingly at stake,

Connally failed to recognise the political and economic imperatives behind other G10 states' insistence on US devaluation. He instead attributed their determination to obtain dollar devaluation as being driven by a desire to humiliate the US. (Writing of the other G10 states, Connally later commented "They just wanted to devalue the dollar - primarily, I think, as a means of embarrassing the United States...the persistent cry that the United States should devalue was partly the desire to see the United States humbled." (Connally and Herkowitz, *In history's shadow*, 242-43). Connally reacted accordingly. Burns, who attended this stormy meeting, noted in his diary that Secretary of State Rogers had called him on his return to Washington to complain of "Connally's ineptness in dealing with foreigners"; Rogers feared Connally might single-handedly "collapse US foreign policy" (Burns and Ferrell, *Secret diary*, 57). The G10 meeting had generated more heat than light. With nothing agreed at Lancaster House, Connally's bare knuckle diplomacy had produced a success for procrastination.

³⁹ Secret Memorandum of Conversation, Connally/Sato, 12 November 1971; Duncombe, *Foreign economic policy*, 538-43

⁴⁰ Confidential Memorandum of Conversation, London, August 16 1971; *Ibid.*, 469-78.

⁴¹ Connally met his British counterpart in Bermuda shortly after the Smithsonian Agreement and admitted he had hoped currencies would float for "at least six months" after August before the G10 finalised the currency realignment the US had sought. (British record of a bilateral meeting between Chancellor Barber, Connally and Volcker at the Princess Hotel, Bermuda, 20 December 1971; Bank of England archive file OV53/42). This meeting was held in the margins of the Nixon-Heath summit taking place in Bermuda at that time.

⁴² Duncombe, *Foreign economic policy*, 485

Schweitzer tried again. At the G10 Finance Ministers meeting in London on 15-16 September he proposed the IMF should lead a three-stage negotiating process. Connally balked at this, calling Schweitzer's approach "premature"; he diverted the meeting into requesting OECD and IMF technical work on exchange rate relativities.⁴³ This created the excuse of needing to wait for the time-consuming technical studies' completion.⁴⁴ In November Connally again refused to negotiate when the Bank for International Settlements' president, Jelle Zijlstra, offered him a secret draft settlement plan. Ironically, Zijlstra had prepared his plan at Burns' request!⁴⁵

Connally's megaphone diplomacy reinforced his delaying tactics. His intention was to reach over the heads of foreign governments to stir up lobby groups abroad helpful to the US cause. He used the media and Congressional committee appearances to broadcast his willingness to procrastinate and block, hoping to convince other states' businessmen and financiers they would have to endure the 10% import surcharge, the "Buy American" tax incentives and the foreign exchange market instability for a painfully prolonged period. He wanted them to urge their governments to make the concessions he needed to achieve his objectives.⁴⁶ Having sparred publicly with Giscard d'Estaing, however, Connally overplayed his hand when visiting Asia.

⁴³ Confidential telegram from US Embassy, London to the Department of State reporting a meeting of Ministers and Governors of the G10, 17 August 1971; *Ibid.*, 492-93.

⁴⁴ The exchange rate relativities study Connally persuaded the G10 Ministers to commission in mid-September was not available from the OECD Secretariat until mid-October.

⁴⁵ See Solomon, *International monetary system*, 196. Zijlstra, President of the Netherlands' central bank and head of the BIS, forwarded his secret plan to Connally on 23 November and drew on it to suggest possible new exchange rate parities at the G10 Ministers meeting in Rome on 30 November-1 December 1971. The US embassy in The Hague reported their post-Rome debriefing of Zijlstra and the aborted use of his plan in a secret telegram to the State Department, 6 December 1971 (Duncombe, *Foreign economic policy*, 586-89).

⁴⁶ The megaphone diplomacy started well for Connally. He gave a well-received US press conference to explain the New Economic Policy in Washington on 16 August. He followed up with a similarly praised television interview on 19 August in which he stated "one way or another" other states would have to pay for the US defence shield (Duncombe, *Foreign economic policy*, 484-85). He was getting his messages across, perhaps too well because the French Finance Minister, Giscard d'Estaing, responded on 23 September at a press conference of his own. Giscard said France too was in "no hurry" to reach a settlement. It feared a rush to consensus that would lead other states to make "exorbitant concessions" to the US "that would finally make a balanced solution impossible" (Solomon, *International monetary system*, 194). Connally relished a challenge. On 19 October he told the *New York Times* that if France was in no hurry, neither was the US (*Ibid.*, 199). By then Connally, in his capacity of chairman of the G10, had postponed a G10 Ministerial meeting scheduled for 22 November and organised for himself an extravagantly extended visit to Asia, leaving Washington on 28 October and not returning until 14 November. Connally visited Indonesia, Thailand, South Vietnam, the Philippines and Japan. According to Volcker the trip had been arranged purely to "make ... Giscard d'Estaing think we did not care" (quoted in Silber, Volcker, 98). This took Connally out

Connally gave a provocative press conference in Indonesia, telling the media there was no prospect of early exchange rate realignment; he was looking forward to “a very relaxed series of meetings” on the topic.⁴⁷ Adding insult to injury, Connally told media in Tokyo that Europe’s disunity was blocking agreement, blamed Europe for cancelling a planned G10 Ministerial and said he would not be surprised if the uncertainty dragged on into 1972.⁴⁸

This was too much for the British, who resented Connally’s tactics. With the Chancellor’s approval, the Treasury’s Second Permanent Secretary, Alan Neale, took the unusual step of calling in the US Embassy’s Financial Attaché for a dressing down. The meeting turned into a full-scale name-calling row, a highly unusual event within the Special Relationship. The US embassy in London reported the meeting to Washington, including British accusations the US was “the basic obstacle” to agreement: the British believed Connally’s tactics were creating “a bleak outlook” for an international settlement.⁴⁹ Britain was the US’ closest - and on international monetary issues arguably its most constructive - ally. Exhausting his closest ally’s patience signalled it was time for Connally to change tack. Moreover, the EEC had at last agreed a common negotiating position on 4 November.

Foreign Opposition

Nixon’s 15 August announcement had caused consternation in Europe and Japan.

Japan’s government was initially the most confused in the G10. Having completely misread US intentions, Japan delayed floating the yen until forced to do so by \$4bn of inflationary capital inflows.⁵⁰ As Connally had calculated,

of Washington at a crucial time as well as out of negotiating range for 17 days, although he did try to persuade Japan to settle bilaterally on his visit to Tokyo on 11-12 November.

⁴⁷ Quoted in Solomon, *International monetary system*, 200

⁴⁸ Duncombe, *Foreign economic policy*, 535

⁴⁹ Confidential telegram from the US Embassy in London to the Department of State, 12 November 1971; *Ibid.*, 535-37

⁵⁰ These increased Japan’s dollar reserves by a staggering 50% in just two weeks.

floating was the only way to choke off such inflows and prevent the recipient's domestic money supply from exploding.⁵¹

Japan's mercantilism was reviled in Europe and Washington; its government found itself completely isolated, unable to buy a friend.⁵² True to mercantilist form, the Bank of Japan minimised the yen's loss of competitiveness by intervening in markets ("dirty floating") to prevent the yen appreciating more rapidly than the deutschemark during autumn 1971. It succeeded: both currencies had appreciated by about 9½% from their 1 May level by the time G10 Ministers met in Rome on 30 November. Despite lacking allies, Japan spurned US efforts to persuade it to make a separate, bilateral deal, probably because Japan feared losing competitiveness if Europe subsequently agreed a better deal with Connally. This aside, Japan contributed little diplomatically to the developing situation.⁵³ The real action was in Europe.

Europe also floundered initially after the "Nixon shock". EEC Economy Ministers met on 18 August without agreeing a response. Differences in economic power across the Community were too great to permit an early

⁵¹ At first the Japanese government believed Nixon had acted simply to protect US gold reserves. Japan was already voluntarily refraining from converting its dollar reserves to gold, so the government initially saw no reason to change its monetary policy. It kept Tokyo's foreign exchange market open and throughout the second half of August continued to defend the Y360/\$1 exchange rate it had maintained unchanged since the Second World War. This lasted two weeks until the government grasped what the US really wanted as the Japanese money supply soared. Japan's narrow measure of its money supply (M1) was approximately ¥24 trillion when Nixon announced he had closed the gold window; it increased by ¥1.5 trillion (6.25%) in the two weeks after Nixon's announcement (Volcker and Gyohten, *Changing fortunes*, 94).

Japan's capital controls were ineffective. Japanese bankers gave their central bank private assurances they were not speculating on a yen appreciation, but these were misleading. Japanese bankers were speculating heavily on the yen appreciating, even borrowing \$2 bn abroad to buy additional yen from the Bank of Japan to maximise their profits when the yen eventually appreciated. The government floated the yen on 27 August to stop the speculation. The government had learned painful lessons about the brutal power of the market's profit-driven behaviour as well as the duplicity of Japan's bankers.

⁵² Gyohten, at the time Special Assistant to the Vice Minister for International Affairs as well as Finance Minister Mizuta's interpreter, noted: "When the United States and the Europeans began criticising Japan's (trade) surplus and its undervalued yen, we did not realise how serious the situation had become..." (Volcker and Gyohten, *Changing fortunes*, 92)

Gyohten revealed "We tried to make an alliance with the French, and then with the Germans, and both failed. We were left with the impression Japan's situation was so special that nobody would form alliances with us in opposing the strong pressure of the United States. That was a rather disappointing discovery, and we later learned the United States was forming alliances with the Europeans to gang up on against us. But instead of examining the situation and trying to discover why we were so isolated, we adopted a very defensive position". (Ibid., 95)

⁵³ Or at the Smithsonian meeting itself. Once he had agreed terms bilaterally with Connally, Japan's Finance Minister hid in a cupboard to avoid contacts with his European colleagues in case these added to the pressure to appreciate the yen!

common reaction to such an event.⁵⁴ It took six weeks of bargaining for EEC governments to piece together their preliminary negotiating objectives, and a further month to overcome internal differences and refine their objectives into something serviceable for diplomatic purposes.

The UK and Canada reacted identically to President Nixon's 15 August announcement: both sought immediate exemption from the import surcharge, unsuccessfully, and then joined the "G9" consensus calling for US devaluation and adjustment.⁵⁵

The FRG represented the interests of Europe's strongest economies. It was successful in world markets and was one of the three states running large trade surpluses with the US. But the FRG was constrained by dependence on US security; its international legitimacy remained compromised after 1945. FRG policy tended to seek "more Europe" as a solution to problems, except where pursuing a European option might jeopardise the FRG-US security relationship. Brandt's election as Chancellor saw the FRG begin to flirt with "Ostpolitik", a policy of reducing East-West tensions by building mutual USSR-FRG interdependence through increased trade. The US and France were suspicious of Brandt's policy, fearing the USSR might detach the FRG from NATO and reduce Bonn's commitment to the EEC.

France represented the economically weaker European states' interests. Its post-War economic recovery had been slower than Germany's. French competitiveness remained fragile after May 1968's disruptions, the FRG's was

⁵⁴ The US ambassador to Luxembourg, Kingdon Gould, reported the EEC's inconclusive and unco-ordinated response in a telegram from Luxembourg to the Department of State, 20 August 1971; Duncombe, *Foreign economic policy*, 485. Gould's suggestion that the US engage with EEC member states to shape the "nature and direction" of their response to Nixon's initiative was abruptly rejected by a procrastinating Washington the following day.

⁵⁵ The UK's first response is revealed in Chancellor Barber's report to a hastily convened Cabinet meeting at 6 pm on 16 August 1971. Barber and Volcker had held a private meeting after Volcker's "consultation" with European and Japanese officials at Wychwood House. Barber told the Cabinet Volcker had admitted the US "had no complaint against the United Kingdom" about unfair trade practices. Barber suggested to Volcker it was therefore "unfair to maintain the surcharge against countries whose trade practices were not disputed", but Volcker pointed instead to the need to realign exchange rates before removing the surcharge. (Secret record of the summary and conclusions of the Cabinet meeting on 16 August 1971; UK National Archive file CAB/128/49/44)

Canada's Acting Prime Minister, Mitchell, wrote to Nixon on 18 August endorsing the US' international monetary reform objective, but protesting against the 10% import surcharge's imposition on Canadian goods. He informed Nixon Canada would shortly be sending officials to Washington to discuss Canada's exemption (Duncombe, *Foreign economic policy*, 484).

robust. Indicating their relative economic power, the FRG appreciated the deutschemark in 1969, whereas France devalued its franc.

France's relationship with Anglo-Saxon states had been prickly since 1940. It did not share their confidence in market forces. It wanted independence from the "Anglos" on security issues. President de Gaulle expelled US bases and withdrew France from NATO's integrated military structure, gaining a measure of security by developing French nuclear weapons. Consequently France did not share German attitudes towards the need for US troops in Europe, nor German attitudes towards inflation.

Both France and Germany had suffered severe inflation at times in the first half of the 20th century, but their societies' reactions had been very different. Germans became neuralgic to inflationary policies. One of the main German complaints about the Nixon administration was its economic policies' inflationary bias.⁵⁶ The French, however, accepted inflation as a fact of life and sought protection in gold, hoarding it as a hedge against inflation⁵⁷. De Gaulle had ensured France exchanged a good part of its surplus dollar reserves for US gold; France had been one of only three states to exchange dollars for US gold in May 1971. Germany, by contrast, had given a written undertaking to the US it would not exchange dollars for US gold. This difference of approach was to have a profound effect on the course of the G10 negotiations in autumn 1971.

Gold's role as a reserve asset and private sector hedge against inflation was a side-issue for the FRG, but was fundamental for France's gold-hoarding population. The FRG did not have strong feelings about whether the US should devalue the dollar against gold as well as depreciate against G10 currencies; but dollar devaluation was essential for France if it were to accept a franc appreciation against the dollar. Had France accepted the US' right to

⁵⁶ See, for example, Bundesbank Vice-President Otmar Emminger's remarks in a speech he gave in Vienna on 31 October 1971, in which he warned the US' ability to curb its inflation, and hence limit other states' uncontrolled accumulation of dollar reserves, would be much more important for international financial stability than the introduction of new, more sophisticated rules on exchange rate flexibility and reserve creation. (Copy of speech contained in Bank of England archive file OV53/42.)

⁵⁷ France's preference for holding wealth in gold rather than paper currency dated back to Louis XV's reign when John Law precipitated a severe financial crash in 1720 by persuading investors to exchange their government bonds for shares in the unprofitable Mississippi Company, the supposed route to tapping the wealth of French possessions in the New World. People holding their wealth in paper currency and shares lost their wealth; those holding gold retained theirs. France never forgot.

depreciate its dollar without also devaluing against gold, the value of French private gold hoards would have been reduced in value in terms of francs.⁵⁸ This would reduce the French population's wealth and undermine its society's long-held belief that gold was superior to paper money as a store of value. French leaders knew their political survival depended on respecting gold.

Social and policy differences aside, Connally's choice of economic levers had very different impacts on France and the FRG. Perversely Bonn, diplomatically the closer of the two to Washington, felt the full force of Connally's leveraging policies. FRG exports were hit by the 10% import surcharge and the "Buy American" elements in the investment tax credit (which discriminated in particular against foreign investment goods: the machine tools and transport equipment at the heart of the FRG's post-War economic revival). Bonn had been under pressure to agree new burden-sharing arrangements even before Nixon's 15 August announcement. And, in the area of trade policy, the US had targeted the Common Agricultural Policy, which Bonn valued highly. Bonn claimed 30% of FRG exports were hit by the US New Economic Policy, but pressure on the FRG export-oriented economy was even greater because its total export effort was affected by the Deutschmark having appreciated strongly against all major currencies (except the yen) after floating in May.⁵⁹

Paris was further from Washington diplomatically than Bonn, yet escaped relatively lightly from Connally's policies. He gained little leverage over Paris. The proportion of French exports going to the US was only half that of the FRG's. France did not specialise in exporting investment goods. It hosted no US troops, so burden-sharing was almost irrelevant to Paris, despite Connally's best efforts. And France could rely on the EEC Commission to defend its trade

⁵⁸ Purely for illustrative purposes, suppose gold was officially valued at \$35 per fine ounce, and the dollar bought 10 French francs. An ounce of gold would be worth F350. If the dollar were then depreciated so it bought only 5 instead of 10 francs, but not devalued against gold (so an ounce of gold remained \$35), then an ounce of gold in a French citizen's hoard would be worth F175, creating a loss for the hoarder. However, the citizen's gold hoard would retain its F350 value if the dollar simultaneously devalued against gold by the same amount as it depreciated against the franc, i.e. devaluing to \$70 per fine ounce. The moral for the French government was that it could not afford to allow the US to depreciate the dollar against the franc by a larger percentage than the US devalued the dollar against gold. Conversely, if the US depreciated the dollar by a smaller percentage than it devalued, French gold hoarders would become wealthier. Consequently French policy was to seek dollar devaluation, but no, or a smaller rate of, dollar depreciation.

⁵⁹ Matusow, *Nixon's economy*, 173

policy and agricultural interests. After all, the EEC Trade Commissioner was trusted in Paris: Raymond Barre, a future Prime Minister.

Capital controls also differentiated France from the FRG. The FRG had virtually none in 1971 whereas France had wide-ranging, highly effective controls. France used its controls to maintain a fixed franc/dollar exchange rate at its Bretton Woods parity after 15 August, the only G10 state to do so. When market forces appreciated other currencies against the dollar, those currencies also appreciated against the French franc. The more time Connally won for his strategy to work, the more competitive France became. France reaped what Connally sowed! Moreover, the French, no admirers of US hegemony, could take satisfaction from Connally upsetting US allies. French diplomatic standing rose as Connally shredded the good-will and hegemonic legitimacy the US had built after 1945. Giscard d'Estaing had not been bluffing Connally on 23 September 1971 when he declared publicly France was in "no hurry" to settle.⁶⁰ The only real pressure on France was the need to embed its interests in a common EEC position and sustain German support.

The Franco-German differences illustrate why Connally's confidence in US power was misplaced and why Burns and Volcker had been right to fear the US lacked the power it needed to put in place unilaterally new rules for international trade and money. The US did not possess sufficient structural power over France (and an EEC united behind it) to reshape the international monetary system as it pleased. The US had sufficient power to enable it unilaterally to refuse to play by the old Bretton Woods rules, a "negative" structural power, but it could not dictate their replacement because it lacked the "positive" structural power over France and the EEC to do so. Strange and her "structural power" supporters were half right, but over-estimated US power.

Connally had overlooked the fact that other states set the dollar's rate of exchange with their national currencies. *They* controlled dollar appreciation or depreciation, not the US. The US was always the *demandeur* on exchange rate issues. It had never accumulated more than working balances in its foreign exchange reserves; its reserves were overwhelmingly in gold, which it now wished to retain. Any US intervention in foreign exchange markets would soon exhaust its foreign exchange reserves. Its weapon for moving exchange rates

⁶⁰ Solomon, International monetary system, 194

was the Federal Reserve's control over US interest rates, which could in theory be used to flood or drain the world of dollar liquidity and create global, generalised (but not bilateral) pressures to depreciate or appreciate the dollar. However, even this blunderbuss weapon was not available to Connally. Burns had locked US interest rates into delivering a buoyant domestic economy to help Nixon's re-election chances. Interest rates could not be used simultaneously to deliver the US' exchange rate objectives. So the US depended on foreign governments and central banks to allow their currencies to float against the dollar and be driven by market forces.

Connally had no policy instrument to deploy against France. It saw nothing wrong with using administrative interventions to control market forces and exchange rates. The FRG could be bullied into floating because the FRG lacked French-style capital controls and feared the inflationary consequences of large dollar inflows. The Bundesbank was obliged to convert dollar inflows to deutschemarks and thus lost control of its money supply and anti-inflation policy as long as the dollar/deutschemark rate remained fixed. Neither Bonn nor Frankfurt wished to risk dollar-driven inflation, so US monetary policy gave Washington economic power over Bonn's decision-making, as Connally expected. But French capital controls disarmed Connally's power play.

Connally was powerless in these circumstances: burden-sharing was irrelevant to the French; they were not especially dependent on bilateral trade with the US; trade policy was an EEC competence; and France was gaining exchange rate competitiveness as Connally procrastinated. His strategy had no means of forcing Paris' hand, or even influencing its decision-making.

France soon demonstrated it could profit from its policy independence by uniting the EEC around French international monetary objectives: no dollar depreciation without devaluation; no massive exchange rate realignment to improve the US current account by \$13 bn; and no diminution in gold's international role. France was fortunate as to the timing of these international monetary events: they coincided with efforts to increase the EEC's membership. France had a veto over which states should be admitted and on what terms. Prime Minister Heath had prioritised EEC membership in British foreign policy so France was able to gain leverage over British policy for a time - a bonus for

Paris. Heath did not wish to risk precipitating either a veto over British membership or increased accession costs.

It was against this background that France and the FRG brought their respective interests to the table when EEC Finance Ministers sought a common response to the US. Little was achieved until the G10 Ministerial at Lancaster House, when Italy, the EEC's spokesman, tabled a list of common European demands on 15-16 September.⁶¹ The list had been cobbled together hurriedly on a "lowest common denominator" basis; it lacked internal coherence and was soon replaced with an EEC agreement to an international Programme of Work for the IMF. This was finalised at the G10 Finance Ministers' meeting in Washington on 26 September in the margins of the IMF Annual Meeting.⁶² EEC cohesion held when Connally attempted to split his opponents by offering to cancel the 10% import surcharge for any state agreeing to liberalise its trade with the US and float its currency "cleanly".⁶³ No state accepted Connally's offer.⁶⁴ EEC cohesion held again at an OECD WP3 meeting in mid-October, when the US and OECD Secretariat attempted to persuade other member states to accept a \$10-13 bn improvement in the US current account. Other states balked at this: a *tour de table* elicited adjustment offers totalling a mere \$3bn gain for the US.⁶⁵ At the time this appeared insufficient even to restore the US current account to surplus.⁶⁶ The EEC was in no mood to surrender to Connally, but on 4 November the EEC agreed substantive proposals that took account of many US requirements, albeit within the context of French demands.

⁶¹ The EEC demanded: an early return to fixed but adjustable exchange rates; wider exchange rate margins around fixed parities and "other" means of limiting short-term capital inflows; a reduced role for the dollar as a reserve currency; and, a new form of convertibility.

⁶² The G10 agreement represented a minor concession by Connally because it went further than repeating the earlier request to the IMF staff and OECD Secretariat to study exchange rate movements (Solomon, *International monetary system*, 193). The G10 agreed the IMF should study international monetary reform, examining in particular the possible magnitude and methods of required exchange rate movements; implications of a temporarily permitting wider exchange rate margins around par values; abolition of the 10% import surcharge; and other methods of improving the US balance of payments. See Williamson (*Failure of world monetary reform*, 56) and Solomon (*International monetary system*, 194).

⁶³ A "clean" float is one in which the central bank refrains from managing the float, thereby exposing the currency fully to market forces.

⁶⁴ Volcker said there was no US expectation Connally's attempt to split the opposition would lead to anything: "We did not expect the offer to be picked up given the antipathy to floating..." (Volcker and Gyohten, *Changing fortunes*, 82)

⁶⁵ See "WP3 Meeting 18-19 October" report: classified "limited official use" telegram from the US Mission to the OECD to Department of State, 20 October 1971 (Duncombe, *Foreign economic policy*, 198-200).

⁶⁶ Solomon, *International monetary system*, 198-99

This break-through combined activist French diplomacy with a German fear the EEC might split over international monetary questions.⁶⁷ The 4 November decision would have been impossible without FRG backing France and a European solution. When Connally's push came to France's shove, FRG Finance Minister Schiller told Connally he was siding with France. Schiller threatened Connally he would drive down the deutschemark's exchange rate against the dollar and introduce French-style currency and capital controls to resist further US pressure.⁶⁸ The FRG consciously lashed itself to a Franco-EEC mast: it did not support the US. With the EEC's Franco-German motor now pulling in the same direction, the rest of the EEC (and Britain) meekly followed. The US hegemon had lost its followers.

EEC member states gave the FRG the task of ensuring Washington would accept Europe's 4 November offer as the basis for the next G10 Ministers discussions. German representatives approached the US privately at least three times to ensure their message got across: twice through messages from Emminger and once through contacts with the US embassy in Bonn.⁶⁹

The EEC offer amounted to a 9% depreciation of the dollar, well short of the Connally's 15% target.⁷⁰ But his strategy of relying on market forces to

⁶⁷ The EEC's proposal, if accepted by the US, would ensure France would not lose competitiveness against Japan or any European state. Only the US would make greater competitiveness gains than France.

⁶⁸ Schiller first alerted Connally to this in a bilateral meeting in the US Treasury in Washington on 25 September. He told Connally the FRG could not cope simultaneously with US demands on exchange rates, trade policy and burden-sharing. Schiller warned the time for depreciating the deutschemark and introducing capital controls was drawing near: "There was very little time left." Confidential Memorandum of Conversation, 25 September 1971 (Duncombe, Foreign economic policy, 506-11). See also Solomon, International monetary system, 199, for a discussion of FRG economic policy priorities.

⁶⁹ Emminger's role is recorded in a personal letter from Emminger to Volcker, 12 November 1971, and a confidential telegram from the US embassy in Bonn to the Department of State reporting the Finance Attaché's "in confidence" conversation with Emminger, 17 November 1971 (Duncombe, Foreign economic policy, 533-35 and 551-54). A secret telegram from US embassy in Bonn to the Department of State reported a conversation between the Financial Attaché and FRG Economics Deputy Assistant Secretary Tietmeyer, 5 November 1971 makes clear State Secretary Schoellhorn had agreed to Tietmeyer providing the US embassy with a nearly complete read-out of the EEC Finance Ministers' 4 November agreement on condition that it was not reported through regular diplomatic channels (Ibid., 546-48).

⁷⁰ German representatives revealed the EEC proposal's main element was the French concession to maintain a "standstill" in the price of gold in francs if the US devalued the dollar by 5-6%, i.e. the US would achieve depreciation against the French franc. This was the first time France had offered to appreciate the franc against the dollar. The US would also achieve depreciation against all other European currencies because the French offer was conditional on Italy and the UK also maintaining a standstill on their currencies' gold price, the Benelux countries revaluing (appreciating) against gold by at least 2% and the FRG appreciating by an unspecified greater amount. All European exchange rate offers were conditional on Japan appreciating the yen against the dollar by more than the deutschemark. Emminger calculated

engineer dollar depreciation was progressing slowly: the dollar depreciated only 4½% during May-November. The EEC was offering to double his exchange rate gains if, Emminger emphasised, Connally agreed within “six weeks”: European and Japanese unemployment was rising; recession loomed. If there were no early generalised exchange rate realignment, the Bundesbank would drive down the deutschemark’s exchange rate to improve the FRG’s economic recovery prospects for 1972. Emminger also warned that if the G10 currency realignment were not agreed soon, i.e. at the Rome G10 Ministerial meeting, the Pompidou/Brandt Summit scheduled for 4 December “might perhaps lay the foundations for a regional monetary set up” (a European currency bloc).⁷¹

Non-EEC states added to the pressure on Connally. On 19 October Denmark announced plans to introduce its own 10% import surcharge on imports from the US, confirming Burns’ fears of trade retaliation.⁷² The UK’s objections to Connally’s strategy were aired on 12 November, as noted above.

EEC member states reinforced their pressures. They claimed they had reached the point at which retaliatory measures might be taken to block interest, profits and dividends remittances from US multinational companies to the US, and create a European currency bloc to compete with the dollar.⁷³ This was the European response the US Treasury most feared.⁷⁴

that if the DM appreciated 5-6% against the French franc and the yen appreciated 12-14%, this package would give the US a 9% trade-weighted depreciation of the dollar. (Schiller estimated the dollar appreciation at 10%.) This was quoted in the secret telegram from US embassy in Bonn to the Department of State reporting conversation between the Financial Attaché and FRG Economics Deputy Assistant Secretary Tietmeyer, 5 November 1971.

⁷¹ Personal letter from Bundesbank Vice-President Emminger to Volcker, 12 November 1971; Duncombe, *Foreign economic policy*, 533-35. It became clear in autumn 1971 that European and Japanese economic growth was slowing and unemployment was rising across the G10; a recession threatened. FRG policymakers wanted an export-led recovery in 1972, for which they believed they needed a more competitive exchange rate than that produced by floating. The Rome G10 meeting, having been cancelled by Connally, was rescheduled to 30 November - 1 December.

⁷² Solomon, *International monetary system*, 199

⁷³ US Ambassador Watson warned from Paris that French restraint on counter-measures might be coming to an end. Watson noted French preparations were in hand to prevent US-owned multinational companies from remitting their profits to the US; and France was beginning to push the FRG to make preparations for a common European currency bloc (Confidential telegram from US embassy in Paris to the Department of State, 15 November; Duncombe, *Foreign economic policy*, 548-50). The US embassy in Brussels reported a conversation with the Belgian Finance Minister in which he claimed a failure to agree a solution based on EEC proposals at the G10 Ministerial meeting in Rome would lead to the Pompidou/Brandt summit on 4 December agreeing to the EEC creating its own currency bloc (Confidential telegram from US embassy in Brussels to the Department of State reporting Chargé d’affaires’ and Economic Counsellor’s meeting with Belgian Finance Minister Snoy, 24 November 1971; *Ibid.*, 569-70). Weary of Connally’s procrastination, the FRG added to the

An unexpected source of European pressure emerged when NATO Secretary-General Luns called on the US embassy in The Hague on 12 November to notify the US he wanted to discuss monetary, trade and burden-sharing issues at NATO's next Ministerial meeting, scheduled for 8-10 December.⁷⁵ Luns told US Ambassador Middendorf that Nixon and Kissinger might consider their proposed arms limitation negotiation in Moscow as NATO's great prize for 1972, but he regarded the rift in the alliance as more important. Luns feared trade restrictions between the US and Europe would become an electoral issue and "get out of control"; retaliation and recession would lead to cuts in military budgets. Luns expected the Soviet Union to play for time, enjoying the row developing within NATO. Confidence in US hegemony could dissolve. Luns claimed Brandt agreed with him. Luns could not have been clearer as to the foreign policy costs of Connally's strategy: achieving US security objectives had come to depend on settling the disputed trade, burden-sharing and international monetary issues. Connally's strategy had reversed what Realists might consider the natural order: progress towards US foreign policy objectives now depended on progress on foreign economic policy issues.

Connally had dismissed Burns' prediction that other states would retaliate if the US closed the gold window and introduced the 10% import surcharge, saying "Let 'em. What can they do?" The answer was clear by mid-November: retaliatory trade measures, intensified currency and capital controls, exchange rate manipulation and creation of a rival currency bloc. The US could prevent the EEC balancing against it only by negotiating and settling before Europe adopted its counter-measures and diplomacy was diverted into dealing with them. This thought had already crossed the minds of a majority of the Foreign Economic Policy Executive in Washington.

pressure. When issuing his invitation to the G10 Ministerial meeting in Rome, Connally had warned his counterparts they should come accompanied by their trade negotiators because US trade demands would be on the agenda. The US embassy in Bonn reported the FRG Foreign Ministry's tart response: it had insisted Washington put forward "concrete US trade proposals" if it genuinely wanted "the ball to be in the European court" (Confidential telegram from US embassy in Bonn to the Department of State, reporting discussion of G10 Ministerial and Pompidou/Brandt Summit, 24 November 1971; *Ibid.*, 571).

⁷⁴ Discussed in chapter 4

⁷⁵ Secret telegram from US embassy in The Hague to Department of State; 15 November 1971; Duncombe, *Foreign economic policy*, 546-48

Domestic Opposition

If it were to succeed, Connally's strategy needed sustained political backing to provide credibility while market forces appreciated other currencies. Other states had to be convinced there was no alternative to dealing with Connally. Market forces worked, slowly, but the political backing dissolved.

Nixon supported Connally, but this was always conditional: foreign economic policy could not be allowed to disrupt his foreign policy objectives. Reluctantly, Burns had accepted the policy of closing the gold window. His support did not last long. He used his independent Federal Reserve platform to undermine Connally. McCracken and Kissinger also came to see matters from Burns' perspective. Shultz had always preferred a different objective - an international monetary system based on freely floating exchange rates and free capital mobility - and thus a different strategy; his support for Connally was never more than lukewarm. Volcker served his Treasury Secretary loyally, but even he could see the writing on the wall by November. Thus Connally's attempt to project US structural power was compromised by colleagues as much as by French-led opposition.

Nixon's conditional support for Connally's strategy was crucial. He met Kissinger and Peterson on the day Japan floated the yen and told them economic crises could not be allowed to obstruct his foreign policy objectives (which at the time included visits to Peking in February 1972 and Moscow for strategic arms limitation talks in May 1972).⁷⁶ Nonetheless, Nixon enthusiastically supported Connally's "play it long" strategy. When Connally and Burns sought guidance from Nixon ahead of the G10 Ministerial meeting on 15-16 September, Nixon told them the import surcharge was good for his domestic politics; they should press the G10 for currency realignment and revised burden-sharing. Burns recorded Nixon's instructions as: "We therefore should not be in a hurry to achieve settlement, that in fact some 'demagoging' on the president's part this year and next was good politics, and that settlement should be postponed until after the (November 1972 presidential) election".⁷⁷

⁷⁶ Haldeman diary entry for 27 August 1971, cited by Matusow, *Nixon's economy*, 167

⁷⁷ Burns diary entry for 10 September 1971 (Burns and Ferrell, *Secret diary*, 54)

Nixon remained steadfastly behind Connally's approach throughout September and most of October. When alerted to Burns-led anti-Connally intrigues, Nixon took exception and on 4 October told Haldeman to set Kissinger against Burns to protect Connally.⁷⁸ Nixon even sent Burns to visit India to help Connally in Washington. Nixon also backed Connally against Shultz. On 25 October Nixon told Shultz he supported Connally, was opposed to replacing Bretton Woods with a system based on generalised floating (Shultz's preference) or restoring convertibility if that would require deflation and higher unemployment (the G10/IMF prescription). Nixon also told Shultz he opposed devaluation to satisfy France (Burns' proposal).⁷⁹

Foreign opposition to Connally's strategy had begun to worry Nixon, however, weakening his support for Connally. At their 25 October meeting Nixon asked Shultz to "broker a solution" within his divided administration, but warned "we have to get Connally on board" before adopting any new approach. Nonetheless Nixon backed Connally at a Quadriad meeting held on 28 October, immediately before Connally's Asia visit.⁸⁰ Connally had reminded the Quadriad of his objectives, saying trade liberalisation was politically the most important objective; he claimed progress on this was essential, even if it meant delaying agreement on his other objectives for a year.⁸¹ Connally warned the Quadriad US agreement to early, separate, exchange rate realignment would be "a mistake of major political importance for the President". Nixon concurred and ordered Connally to split the G10 opposition by striking a bilateral deal with

⁷⁸ Haldeman recorded Nixon's instructions in his diary for 4 October: "Set Kissinger against Burns. They're playing an anti-Connally game. Kissinger must stick four-square with Connally. Arthur wants to give away the store. Connally's standing firm. Arthur's playing like the State Department." Quoted by Matusow, *Nixon's economy*, 174

⁷⁹ The White House tapes record Nixon saying "I'll be damned if we are going to raise the price of gold like Arthur (Burns) wants" (Duncombe, *Foreign economic policy*, 521-24).

⁸⁰ This meeting was reinforced by the participation of Kissinger, Flanigan (Assistant to the President 1969-72; thereafter Executive Director of the Council for International Economic Policy) and Peterson (Assistant to the President for International Economic Affairs and Executive Director, Council for International Economic Policy, January 1971-January 1972. Peterson was also appointed chairman of the "Co-ordination Group" established to work on international monetary reform in September 1971 until November 1971. He attended the Quadriad meeting in that capacity.)

⁸¹ These had evolved slightly from those Connally pursued in September. Connally said his objectives now were: a significant currency realignment; no return to convertibility for at least two years; agreement on trade principles and removal of some trade barriers (to be specified later); agreement to reduce gold's role; and the dollar no longer to be the international monetary system's "vehicle currency" (implying another currency or the SDR would have to serve as the system's numeraire). He did not mention burden-sharing (Duncombe, *Foreign economic policy*, 521-24).

Japan.⁸² Nixon followed up by reminding Quadriad participants to avoid speculating about devaluation or convertibility, but Nixon revealed his unease to Burns the following day.⁸³ Burns empathised, “Maybe we will need to change our position (on international monetary issues). It may be having undesirable political effects.”⁸⁴ Nixon directed Burns to speak to Kissinger.

Nixon backed Connally publicly on his return from Asia, but this was just for appearance’s sake.⁸⁵ Nixon had withdrawn his support for Connally’s strategy by 12 November under pressure from Burns, Kissinger and McCracken. Connally’s goose had been cooked during his two weeks in Asia.

Burns had reluctantly supported Nixon’s New Economic Policy at Camp David. He did not support it for long. He worried about the US’ loss of legitimacy: Burns described this in terms of losing other states’ “good will”. And he was concerned Connally had underestimated other states’ power and retaliatory capacities. Burns lost no opportunity to draw Nixon’s attention to other states behaving as he had predicted once Connally had implemented his strategy. When Nixon accepted a joint Kissinger/Peterson proposal to refine the still-vague details of Connally’s strategy by creating a small “Co-ordination Group” on 20 September, Burns warned Connally “...lacked understanding of other countries”, other states “... have enough power to frustrate our economic objectives” and were in the “... process of establishing a common front against the US”; Burns implored Nixon to agree to State Department and NSC participation to ensure the Group would contain foreign affairs expertise.⁸⁶

⁸² This was the purpose of Connally’s secret meeting at Japanese Prime Minister Sato’s house on 12 November 1971, as reported in the secret Memorandum of Conversation, 12 November 1971; Duncombe, Foreign economic policy, 538-43.

⁸³ Secret Memorandum from President Nixon to members of the Quadriad, 2 November 1971; Duncombe, Foreign economic policy, 528

⁸⁴ Burns diary entry for 29 October 1971 (Burns and Ferrell, Secret diary, 61-62)

⁸⁵ Connally defended his strategy robustly at a meeting with senior Republican Congressmen in the White House on 16 November. Nixon supported Connally, telling the Congressmen “the United States has not bargained hard for a better position in world trade (for 25 years); the Goddamn State Department hasn’t done its job. We’re changing the rules of the game” (Duncombe, Foreign economic policy, 173). Nixon banished Peterson to the Commerce Department the same day to please Connally, who resented Peterson’s intrusions on Treasury territory. Haldeman recorded in his diary for 16 November 1971 that Connally had side-lined Peterson by having him moved abruptly from the White House: “Earlier that day Nixon had told Shultz ‘to take Peterson totally out of the play on international financial policy’. This arises from Connally’s feeling that ‘we’re speaking with too many voices’. Connally wants Shultz, McCracken and Peterson ‘to have no more external talks, especially with foreigners’”. Haldeman added “...actually the one he’s after is Peterson” (Haldeman, Diaries, 375).

⁸⁶ Burns diary entry for 20 September 1971 (Burns and Ferrell, Secret diary, 56). The joint Kissinger/Peterson proposal was contained in the confidential Action Memorandum from

Burns argued - in Cabinet on 7 October and on other occasions, including publicly at Congressional committee hearings - the US had forfeited other states' good will by closing the gold window unilaterally, and imposing the 10% import surcharge and "Buy American" tax credit; other states would retaliate at some point.⁸⁷ Burns also argued procrastination was wrong: time was not on the US' side because economic growth was slowing in Europe and Japan. A recession was likely: unemployment was rising already. Weakening economies would create domestic opposition abroad to currency appreciation or trade or burden-sharing concessions. The longer the US delayed agreement, the worse the terms Europe and Japan would concede to the US. McCracken, whose influence with Nixon was fading fast, supported this argument.⁸⁸

Burns identified France as the US' key interlocutor in international monetary affairs and studied French views on gold and its political importance. He communicated his understanding to Nixon in a way Volcker and US Treasury officials had never managed.⁸⁹ His appreciation of the political constraints on the French government led Burns to believe a settlement was impossible unless the US agreed to G10 states' demands to devalue the dollar. Burns therefore advocated devaluation in his discussions with members of the Foreign Economic Policy Executive, convincing even Kissinger by November.⁹⁰

the President's Assistant for National Security Affairs and the President's Assistant for International Economic Affairs to President Nixon, 20 September 1971; Connally supported the proposal and the Group first met on 22 September (Duncombe, Foreign economic policy, 494-95).

⁸⁷ Burns' diary records his contribution to the 7 October Cabinet discussion of international monetary policy (Burns and Ferrell, Secret diary, 57).

⁸⁸ McCracken's star had waned within the White House with "gradualism's" failure. He offered his resignation in summer 1971, but was persuaded to remain until December, when Herbert Stein replaced him as CEA chairman. Having supported the New Economic Policy and Connally's strategy initially, McCracken soon supported Burns' views as unemployment rose in Europe and Japan and threats of retaliatory actions increased; he briefed Nixon accordingly. See, for example, McCracken's unclassified Memorandum from the Chairman of the Council of Economic Advisers to President Nixon, 24 November, in which he warned the president that OECD member states were likely to respond to recession by inflating their money supplies and thereby depreciating their currencies against the dollar, making it more difficult to obtain an international monetary agreement on terms acceptable to the US (Duncombe, Foreign economic policy, 567-68).

⁸⁹ Personal and confidential Letter from the Chairman of the Board of Governors of the Federal Reserve System to President Nixon (copied to Connally); 14 October 1971; Duncombe, Foreign economic policy, 515-17).

⁹⁰ Burns recommended the US devalue against gold by 5-6% in his personal and confidential letter to Nixon of 14 October 1971 (Duncombe, Foreign economic policy, 515-17); he reiterated his proposal in the Quadriad meeting chaired by Nixon on 28 October (Ibid., 521-24); and, with Connally, he urged Nixon to accept devaluation at their White House meeting on 24 November (Ibid., 564-67).

Burns' early opposition to Connally's strategy irritated Nixon, but Burns persisted, warning Nixon of an approaching recession in Europe and Japan and the adverse consequences for Connally's strategy.⁹¹ When Connally went to Asia, Burns again lobbied Nixon on 29 October. Nixon's views began to shift: he worried Connally's approach might have "undesirable political effects". Instead of ignoring Burns' concerns as before, Nixon instructed him to discuss them with Kissinger.⁹² Before having the chance to do so, on 1 November Burns told the House Banking and Currency Committee he had "grave doubts time is on our side in international monetary negotiations".⁹³ Nixon's two main economic policymakers were publicly at loggerheads. Nixon needed a solution.

Burns had tried to influence Kissinger's views as well as Nixon's. He compiled an ever-lengthening list of other states' threatened counter-measures, showing it to Kissinger periodically.⁹⁴ Burns wanted Kissinger to persuade Nixon to regard Connally's strategy from a foreign policy, not domestic political, perspective. When Burns met Kissinger on 3 November, he assessed Kissinger now shared his views of the risks of delaying settlement.⁹⁵

Kissinger, like Burns, was concerned about Connally's impact on his own area of responsibility. Kissinger saw his job as helping Nixon manage the transition from global bipolarity to multipolarity, a difficult task not made easier by unnecessary confrontations with Europe and Japan, two of the emerging poles.⁹⁶ Whereas Kissinger was impressed by Burns, he was worried Connally "was sufficiently Texan to enjoy a good scrap for the sake of it".⁹⁷ Kissinger threw his weight behind Burns in the Foreign Economic Policy Executive.⁹⁸

⁹¹ Personal and confidential Letter from the Chairman of the Board of Governors of the Federal Reserve System to President Nixon; 14 October 1971 (Ibid., 515-17).

⁹² Burns diary entry for 29 October 1971 (Burns and Ferrell, Secret diary, 61-62)

⁹³ Quoted in Solomon, International monetary system, 196.

⁹⁴ Kissinger recalled being influenced by Burns' list: "I was reinforced in this view (to stop-short of all-out confrontation) when Arthur Burns showed me a list of retaliatory measures planned by our major trading partners which would produce on balance an outcome highly disadvantageous to us". (Kissinger, White House years, 957)

⁹⁵ Burns' diary entry for 3 November 1971 (Burns and Ferrell, Secret diary, 62). By 3 November Kissinger would have been aware of the growing risks of EEC retaliation and the EEC Finance Ministers' likely agreement on its 4 November package.

⁹⁶ Discussed in chapter 3

⁹⁷ Kissinger assessed Burns was "...both brilliant and incredibly persistent; and he proved to be one of the canniest bureaucratic infighters in Washington" (Kissinger, Years of upheaval, 81). For Kissinger's views on Connally, see Kissinger, White House years, 957

⁹⁸ Kissinger recalls "at first I was sympathetic with Connally's view that without a measure of confrontation our trading partners would avoid the hard choices implicit in a major (exchange rate) realignment" (Kissinger, White House years, 957). But NSC staff members

Kissinger's priority was to ensure success in Nixon's summits in Peking and Moscow, both part of Nixon's strategy of managing the shift from bipolarity to multipolarity. Washington's hand would be strengthened if the Western alliance were united behind it, a unity Connally was shredding through his confrontational attempt at domination. With Burns' and McCracken's blessing, Kissinger persuaded Nixon to cut short Connally's strategy and assert his foreign policy's priority over Connally's foreign economic policy.⁹⁹ Kissinger convinced Nixon to meet European leaders to heal the Connally-created transatlantic rift and consult them on the forthcoming summits.¹⁰⁰ Kissinger thus succeeded in steering Nixon away from Connally's tactics of hegemony by domination and back to hegemony by consent. This was a major turning point.

Demonstrating Washington's new preference for consensus in place of domination, Kissinger dropped his original idea of a single multilateral consultation exercise when France objected. He agreed instead to consultation through a series of bilateral summits with European leaders: Pompidou, Heath and Brandt, in that order. Nixon agreed. Kissinger sent a "back channels" message to Pompidou on 9 November proposing a bilateral summit; Pompidou

were worried about Connally's approach from the start, warning Kissinger against accepting Connally's opaque negotiating strategy, his stalling tactics and his over-estimation of the import surcharge's value as leverage (Confidential Information Memorandum from Robert Hormats of the National Security Council Staff to the President's Assistant for National Security, 21 August 1971; Duncombe, Foreign economic policy, 484-85). Hormats warned Kissinger on 6 September that Connally had overestimated the leverage he could obtain from the 10% import surcharge. Hormats advised Kissinger the surcharge could be used to force an exchange rate realignment, but not achieve better burden-sharing and trade concessions as well (Confidential "Talking Points for CIEP Meeting", Memorandum from Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs, 6 September 1971; Duncombe, Foreign economic policy, 488-91).

⁹⁹ Kissinger argued "...the optimum time to settle is when the other side is still suspended between conciliation and confrontation. Once it has decided on confrontation it cannot yield until a test of strength is far advanced. My preference was, therefore, to go along with (Connally's) hard-nosed negotiating for a time but to stop short of all-out confrontation that would threaten our Alliance relationships" (Kissinger, White House years, 957).

¹⁰⁰ Kissinger began on 2 November by floating the idea of holding a single international conference with Western leaders. Nixon was in favour; early soundings revealed the French were not. France had succeeded on 4 November in persuading EEC Finance Ministers to agree to French terms for a settlement: the EEC would agree to currency appreciations only if the US devalued the dollar against gold. Pompidou did not want to put France's hard-won bargaining position at risk in yet another multilateral meeting involving the US' security allies in which Washington might succeed in isolating France. Pompidou therefore suggested to Kissinger the US should arrange a series of bilateral summits with European leaders. Furthermore, Pompidou demanded the US refrain from discussing international monetary affairs with other states until he and Nixon had discussed these matters bilaterally (Kissinger, White House years, 958). This was a clear signal that France was ready to settle and, moreover, could deliver the EEC. Kissinger accepted Pompidou's proposal. On 9 November he instructed Richard Watson, US ambassador to France, to arrange the proposed bilateral summit with Pompidou. Pompidou agreed on 12 November, provided the meeting was held at a neutral venue in the Azores on 13-14 December.

signalled his acceptance on 12 November, provided the summit with France would be the first.¹⁰¹ A monetary settlement of some description was inevitable from that moment onwards: the two Presidents would not have committed their political capital and prestige unless agreement was in prospect.

Four members of the Foreign Economic Policy Executive - Burns, Kissinger, McCracken and, crucially, Nixon - now favoured early settlement of the monetary, trade and burden-sharing issues that had divided the US and its G10 allies since August. They did so because, as neoclassical realism theory predicted, they gave priority to US security interests and dealing with international imperatives while subordinating the domestic politico-economic considerations which at that point were still driving Connally's and Volcker's efforts.¹⁰² (Shultz was a peripheral figure in these discussions, isolated by his Friedmanite ideology.¹⁰³) Fortuitously, the Co-ordination Group - formed in September to refine Connally's strategy - completed its work in early November. Treasury officials fed the Group's conclusions into a strategy paper. Connally circulated it for comments on 20 November, opening his strategy to internal scrutiny eight days after Nixon had quietly cancelled it.¹⁰⁴

¹⁰¹ Duncombe, *Foreign economic policy*, 531

¹⁰² Volcker was relatively slow to come round to others' way of thinking on these issues. He records it was not until late November he independently reached the conclusion it was time to for the US settle matters and accept the devaluation he had previously strongly opposed. This realisation coincided with him representing the US at the G10 Finance Ministers' meeting in Rome. (Volcker and Gyohten, *Changing fortunes*, 84-85)

¹⁰³ Shultz wanted to create an international monetary order based on floating exchange rates. He invited Connally to his house to meet Milton Friedman in September in the hope of persuading Connally to agree (Matusow, *Nixon's economy*, 172). Bizarrely, on the eve of the IMF Annual Meeting in September 1971 Shultz presented Connally with a draft speech for him to deliver in which Connally would commit the US unilaterally to a reformed international monetary order based on floating exchange rates. Given a choice between Shultz's Friedmanite draft and Volcker's orthodox draft advocating return to a fixed rate order, Connally opted for the latter (Volcker and Gyohten, *Changing fortunes*, 82). Shultz's only other notable pre-Smithsonian contribution to the debate was to produce another "alternative draft", this time an alternative to the Treasury strategy paper Connally circulated on 20 November. But Shultz's version was, if anything, more orthodox than the Treasury's by this point: his draft advocated a fixed, not floating, exchange rate system, and he loyally reflected Nixon's determination to avoid dollar devaluation, whereas the Treasury's paper left the door open for this.

¹⁰⁴ Unclassified, undated Treasury paper distributed on 20 November, *Summary of Proposed approach towards Monetary-Trade-Burden Sharing Negotiations within the Next Several Weeks* (Duncombe, *Foreign economic policy*, 557-61).

The strategic and tactical refinements Connally included in the Treasury paper came too late to save his strategy. The Treasury's called for the US to achieve a \$9.6 bn improvement in its current account balance through obtaining a 10% depreciation of the dollar. In addition, the paper argued, the US should aim to achieve a \$600 m annual gain from improved burden-sharing arrangements with NATO and agree various bilateral trade measures, such as a new automobile agreement with Canada and agricultural concessions from the EEC and Japan. The paper's trade measures were not costed, but Volcker had earlier estimated a

Connally appeared unaware the ground had shifted under his feet while in Asia. He wanted, and perhaps expected, his divisive strategy to continue well into 1972. He convened a press conference on returning from Asia on 13 November and, contradicting Burns' comments to the House Banking and Currency Committee on 1 November, he told the media the current monetary uncertainty could continue "for an almost indefinite period" and the US would not suffer if it did because its economy "is doing very well". Such statements caused alarm in the White House, as well as in the US private sector.¹⁰⁵

Nixon handled the truculent, uninformed Connally carefully. He met Connally twice on 22 November and again the following day and, after rescheduling his diary, three times on 24 November.¹⁰⁶ Nixon brought Connally up to speed on the change of strategy and discussed the line to take when Burns and Volcker attended the G10 Finance Ministers' meeting in Rome Connally would chair. Once Connally had accepted the need for an early G10 settlement, Nixon focussed discussions on the US' price for it. They also discussed how to choreograph the G10 Ministerial meeting in Rome and the Pompidou Summit in the Azores, 13-14 December: like Pompidou, Nixon wanted the key decisions to be taken by presidents, not their finance ministers.

Connally tacitly admitted his strategy had backfired in his meeting with Nixon on 23 November. He accepted procrastination had left no time in 1971 to progress trade initiatives, which were politically important in the US, or improve the US public's understanding of exchange rate realignment, which was where he assessed "the real money" to be for the US.¹⁰⁷ With Nixon now intent on an

similar trade package might improve the US' current account by \$750 m annually. (See report of the Volcker Group meeting of 31 August 1971 included in the confidential Memorandum from Deane R. Hinton of the Council for International Economic Policy Staff to the President's Assistant for International Economic Affairs, 1 September 1971; Duncombe, *Foreign economic policy*, 486-87.) Taken together, these measures might therefore improve the US' balance of payments by some \$11 bn annually, which was close to Connally's original \$13 bn target.

¹⁰⁵ Peterson reported to Nixon Connally's 13 November remarks, as well as some horrified US private sector reactions, in his confidential Information Memorandum from the President's Assistant for International Economic Affairs to President Nixon of 15 November 1971; Duncombe, *Foreign economic policy*, 554-56. Peterson said his attention had been drawn to the fragility of the US stock market and "precarious" corporate situation. Peterson passed on outsiders' requests for Connally to "cool it", cease 'sabre rattling', and end the 'don't give a damn attitude'. Connally persuaded Nixon to remove Peterson from the White House staff the following day.

¹⁰⁶ See Haldeman, *Diaries*, 378, and Duncombe, *Foreign economic policy*, 564-67. Haldeman records the meetings covered the budget, domestic economic affairs and international monetary policy.

¹⁰⁷ Duncombe, *Foreign economic policy*, 564

early settlement, Connally had to accept the US would be aiming for exchange rate realignment only, perhaps accompanied by some window-dressing on trade and burden-sharing (agreement on an updated FRG defence offset arrangement was imminent). This was a bitter pill for Connally. On 24 November Volcker warned Burns Connally was “an angry man”, protesting “I did not take this apart to put it back at a cheap price.”¹⁰⁸

Nixon’s policy reappraisal included devaluation; this time it was Nixon’s turn to back down. He had insisted throughout there should be no dollar devaluation.¹⁰⁹ Yet on 24 November he found himself discussing with Connally, Burns and Kissinger not whether but when to concede devaluation: at the G10 meeting in Rome or at the Azores Summit? Connally and Burns advised Nixon devaluation was essential to placate France and unlock the early settlement he now demanded. They assured Nixon his political concerns were misplaced: Reuss, the respected Congressman, had changed his position and now advocated devaluation.¹¹⁰ Connally felt he could manage Senate opposition, despite his lack of progress on trade issues.¹¹¹ Nixon accepted these arguments, instructing Connally, Burns and Volcker to make progress in Rome, but not reach a settlement: that was for the Azores.¹¹²

Resumption of Co-operation: Four Meetings and an Agreement

Despite Connally’s initial confidence, the US had failed to exert anything more than negative structural power during August-November 1971. Connally’s

¹⁰⁸ Burns’ diary entry for 26 November 1971 recording the circumstances surrounding his breakfast meeting with Connally on 24 November (Burns and Ferrell, Secret diary, 63-64)

¹⁰⁹ He had three reasons: reputational (no US president had authorised devaluation since the Great Depression); political (the need to obtain Congressional approval) and economic (it appeared at that time a reformed international monetary system would probably be based on SDRs; a devalued dollar would buy fewer SDRs).

¹¹⁰ Solomon, International monetary system, 197

¹¹¹ Matusow, Nixon’s economy, 176

¹¹² Connally recalled the devaluation discussion being relatively relaxed: “I asked (President Nixon) if he had any problems, politically or otherwise, in the US devaluing the dollar.

“He asked, ‘Do you?’

“I said, ‘Not in the least. Wouldn’t bother me at all.’ He said, ‘Neither do I. Do what needs to be done.’

“I asked if he had a feel for how much we should devalue. He said, ‘No, you’re authorised to take whatever action is necessary.’” (Connally and Herkowitz, In history’s shadow, 243)

attempt at hegemony through domination was over-ambitious: the US lacked the positive structural power it needed to impose new rules on the international monetary order. G10 states had ceased to treat the US as their monetary hegemon, refusing to follow its lead. The Foreign Economic Policy Executive's unity had shattered when faced with French-led European intransigence. If Washington wished to resume its monetary hegemony, it needed to switch its hegemonic strategy from domination to consent.

Nixon's meeting with Connally on 24 November marked the start of that tactical switch. Within 24 days the US sought consensus in no less than four substantive international meetings. As Liberal theorists expected, Washington had to pay a price to secure its partners' co-operation: a dollar devaluation; a much lower dollar depreciation than Connally had wanted; acceptance trade liberalisation would be postponed and that the FRG and Japan would pay little extra for their defence. The 10% import surcharge was scrapped, but gold convertibility remained suspended, held back as a bargaining chip to help Washington win future international monetary reforms.

G10 meetings in Rome

The first international meeting, the G10 Deputies meeting in Rome on 29 November, revealed the huge change in the US' approach. Having spent months concealing from its partners what the US expected of them, Volcker arrived in Rome proposing to publish a memorandum outlining what the US wanted: an 11% appreciation of other G10 currencies and promises to negotiate on trade and burden-sharing "in good faith" in return for import surcharge abolition, but no resumption of convertibility. His G10 counterparts were horrified by the sudden, unexpected US transparency. They objected to the memorandum's publication; it leaked to the press anyway.¹¹³

¹¹³ Volcker claimed, somewhat implausibly, another delegation must have been responsible for the leak (Volcker and Gyohten, *Changing fortunes*, 85).

G10 Finance Ministers and central bank governors met over the next two days. Volcker described it as “the most interesting (meeting) of my career”.¹¹⁴ It was certainly unusual.

Connally chaired the meeting (it was his turn), so Volcker replaced him as the US “Finance Minister”. Volcker led the discussion by asking, supposedly hypothetically, how other states would react to a US devaluation of 10-15%. Connally immediately narrowed discussion to a hypothetical 10% devaluation as the US “contribution” to adjustment. Almost a full hour of silence followed. G10 Finance Ministers had not expected their demands for a US devaluation to be met at all, let alone 10-15%. Volcker recalled:

“There was no answer, no discussion, no attempt to change the subject, no call for a recess; for almost an hour there was just silence. Some smoked, some whispered a little to their colleagues, some just fidgeted, but no one wanted to take the lead in addressing the meeting.”¹¹⁵

At one point Connally theatrically cupped his hand to his ear and called out “I can’t hear you”. Eventually Schiller broke the silence, offering a 12% appreciation. This was less than the US wanted, but more than others in the EEC were prepared to accept. France wanted to reduce the US devaluation to 5-6%, with a commensurate reduction in the European offers of currency appreciations. But Giscard d’Estaing could say nothing: he was under instructions to leave the negotiations and settlement to Pompidou at the Azores bilateral summit. So nothing was agreed on exchange rates. There was, however, a new sense of progress and that an early settlement was possible.

The G10’s agenda included trade issues. Connally had asked his counterparts to bring trade negotiators with them to facilitate progress. But this part of the agenda fared no better than the monetary element.¹¹⁶ Connally invited the EEC to call their trade negotiator, Raymond Barre, into the room. He arrived protesting he had no negotiating mandate from the member states. With Ministers from all six member states present, Connally offered to recess

¹¹⁴ Ibid.

¹¹⁵ Ibid., 86

¹¹⁶ Ibid., 86-87

the meeting so the six could produce the mandate Barr claimed to need. They refused his offer: procrastination was not Connally's monopoly!

Trade and burden-sharing

Washington tried to progress its trade agenda over the following two weeks. Fruitless meetings were held with the EEC Commission on 11 December and with Japan in Hawaii on 12 December.¹¹⁷ Connally threatened the US would not devalue unless other states reduced their import barriers. His final mercantilist threat failed: G10 opposition forced him to back down.¹¹⁸

The US obtained no EEC trade concessions in 1971 and minimal progress on Japanese trade liberalisation, although citrus fruit trade was liberalised eventually.¹¹⁹ The latter, unimportant from a balance of payments perspective, was politically useful to Nixon because it appeased a vocal domestic lobby, as had October's agreement to tighten US import quotas on Japanese textiles.¹²⁰ Trade negotiations lingered into February 1972 when the US achieved further minor gains. Washington's main achievement, however, was to build a consensus within the G10 to initiate a new multilateral trade liberalisation negotiation, the Tokyo Round.¹²¹ The prospect of multilateral and reciprocal liberalisation engaged other states in trade liberalisation a way the

¹¹⁷ French blocking tactics ensured the EEC Commission still lacked the necessary formal negotiating mandate, but the EEC Council agreed a "Declaration of Intent" to negotiate. (The implications of the "Declaration of Intent" are discussed in detail in a confidential telegram from the US Mission to the European Communities to the Department of State; sent on 12 December 1971; Duncombe, *Foreign economic policy*, 593-94). It made no practical difference. Commission officials proclaimed themselves "astounded" by the US' trade demands; no progress was achieved in 1971 (Solomon, *International monetary system*, 204). The negotiations with Japan are discussed in Matusow, *Nixon's economy*, 176

¹¹⁸ *Ibid.*, 178

¹¹⁹ Japan also agreed to minor liberalisations of import controls on cosmetics, pharmaceuticals and photographic film (black and white only, colour was excluded!); the government agreed the US' share of the Japanese computer market could rise from 47% to 50%; and it promised to permit US' retailers to operate up to a combined total of 11 branches in Japan. The frugality of these concessions is testimony to Japan's enduring mercantilism and its aversion to trade liberalisation.

¹²⁰ Volcker and Gyohten, *Changing fortunes*, 90

¹²¹ This was formally launched in Tokyo in September 1973 as the Tokyo Round, the seventh round of GATT trade negotiations. It was concluded in 1979. The negotiations included non-tariff barriers to trade for the first time as well as tariffs, reflecting the US' belief that changes in relative prices alone would not materially improve access for US exports.

US' unilateral demands had failed to do: hegemony by consent was proving more productive for Washington than hegemony through domination.¹²²

Burden-sharing negotiations were more fruitful than trade negotiations for the US in 1971, producing an annual balance of payments improvement of some \$0.8-0.9 bn. The Japanese government refused US requests for military base funding, but offered credible assurances it would increase its military procurement from the US from \$200m annually to \$300-400m.¹²³ The US and FRG initialled a new three-part offset agreement on 10 December which improved the US balance of payments by \$1.4 bn over two years.¹²⁴ The NATO Ministerial meeting on 8-10 December produced no economic gains for the US.¹²⁵ Whereas Washington had been able to leverage its military power into achieving relative economic gains in bilateral negotiations with the FRG and

¹²² Progress on trade issues were subject to the same dynamics as monetary issues. The US had the negative structural power it needed to block trade unilaterally as, for example, when Nixon threatened to use the Trading with the Enemy Act to oblige Japan to accept voluntary restraint limits on its textile exports to the US. But the US lacked the positive structural power necessary to oblige other states to open their markets to US exports unilaterally and without reciprocal US concessions. The US could not unilaterally re-write international trade rules or overcome the effects of international trade structures, notably the GATT regime, on states' trade practices.

¹²³ The Japanese refusal to fund US bases, and the credibility of its commitment to double defence purchases from the US were reported in a telegram from the US Embassy in Japan to Department of State, 23 October 1971, classified "limited official use" (Duncombe, Foreign economic policy, 201-04).

¹²⁴ The FRG-US offset agreement's full text is contained in the confidential telegram transmitted from the US embassy in Belgium on behalf of the Secretary of State to the Department of State, 10 December 1971 (Duncombe, Foreign economic policy, 213-14). The two year US-FRG agreement incorporated three elements: increased FRG procurement of US military equipment and services; FRG budgetary contributions to fund US military base upgrades; and, a low interest 4½ year loan from the Bundesbank. The package's total value was DM 6.6 bn, but it was not all new money. Excluding the recycled elements from an earlier agreement, the US' balance of payments gain was only DM 4.8 bn (\$1.4bn) over the two years.

¹²⁵ The NATO Ministerial meeting in Brussels on 8-10 December produced no substantive benefits for the US. In September Nixon had decided he wanted other NATO member states to spend an extra \$2 bn per annum on defence in each of the next five years (National Security Memorandum 133 of 21 September 1971; Duncombe, Foreign economic policy, 194). In November Connally demanded NATO states should increase defence spending and generate \$600m of US current account gains through increased US defence equipment exports and lower spending on US military bases abroad (See unclassified, undated Treasury paper "*Summary of Proposed Approach to Monetary-Trade-Burden-Sharing Negotiations within the Next Several Weeks*" circulated by Connally on 20 November 1971; Duncombe, Foreign economic policy, 557-61). Connally increased his burden-sharing bid in December, lobbying Nixon and Secretary of State Rogers to press NATO to take on \$900m of the \$1.2 bn annual costs of US bases in NATO, and seek \$700m in compensation from France for the costs of it withdrawing from NATO's integrated military structure. Connally failed: NATO members agreed to increase their combined military spending by \$1 bn annually, only half Nixon's target (FCO Guidance telegram No. 9 of 14 January 1972; Bank of England archive file 6A 213/1). NATO members also refused the US request for \$900m of military base funding. France refused to compensate the US (Secret Memorandum from Treasury Secretary Connally to President Nixon, 6 December 1971, Duncombe, Foreign economic policy, 207-08). Moreover, they did so while also approving new spending on NATO's European Defence Improvement Programme which, as Connally had pointed out to Nixon and Rogers, created no financial gain for the US.

Japan, US influence was diluted in NATO's multilateral forum because many NATO members were less sensitive to the US' role than the FRG and Japan.

Nixon-Pompidou Summit

Nixon had two objectives: to limit damage to US relations with Europe and Japan by settling the international monetary dispute; and to discuss international security matters ahead of his visits to Peking and Moscow.¹²⁶ He met Pompidou on 13 December, intent on clearing the decks of the monetary distraction so he could get to the security topics that really interested him.

Pompidou, a former Rothschild banker, had different priorities. He arrived in the Azores determined to achieve a solution that would include a return to fixed exchange rates, a modest dollar devaluation against gold (of around 5-6%) consistent with France accepting an equally modest appreciation of its franc against the dollar, a US commitment to defend the new exchange rates and a currency realignment that would include much large appreciations for the Deutschmark and yen, with no loss of competitiveness for the franc except against the dollar. He gave Nixon a long lecture "on gold and the evils of the dollar standard ... (which) Nixon patiently heard ... out, waiting to get to the problems of mutual defence and security that were his concerns".¹²⁷

Eyewitness accounts of the negotiation differ.¹²⁸ What is clear, however, is that Kissinger, Connally and Volcker played an important role in the negotiation, and both Nixon and Pompidou got what they wanted, or at least thought they had. Nixon came away with a monetary agreement, having agreed to devalue the dollar from \$35 per fine ounce to \$38. Pompidou believed he had got everything he wanted, albeit at the cost of conceding

¹²⁶ Nixon discussed international monetary problems with Connally and Burns in the White House on 24 November 1971. White House tapes record him saying he intended to use the Azores summit "to wrap up this whole thing" (Duncombe, *Foreign economic policy*, 566).

¹²⁷ Volcker and Gyohten, *Changing fortunes*, 88

¹²⁸ Kissinger's detailed recollections place himself centre stage, the main interlocutor between the US team and Pompidou, with Giscard d'Estaing and Connally peripheral figures (Kissinger, *White House years*, 959-62). Volcker's account, which is broadly consistent with Haldeman's diary entries, describes how "Connally, Giscard d'Estaing and I sat in another room (to the presidents') developing an outline of an agreement covering nearly all the issues", leaving the key issue of the extent of the dollar devaluation to be settled by the presidents on the second day (Volcker and Gyohten, *Changing fortunes*, 88). Neither Nixon nor Connally record these events in their autobiographies; Burns, McCracken and Shultz were not present.

slightly larger dollar devaluation (franc appreciation) than he had first proposed. But an ambiguity in their agreement would haunt both leaders.

This concerned the responsibility for defending fixed exchange rates. The US had never done so under the Bretton Woods regime: other states' central banks defended exchange rate parities. Pompidou saw this as an unwarranted US privilege: the US could issue as many dollars while others had to cope with the exchange rate implications. This was not a problem when the US ran "sound" monetary policies, but proved unmanageable when Burns' Federal Reserve flooded the world with dollars. Nixon dodged any overt commitment to intervene to defend the dollar's new exchange rate in his negotiation with Pompidou. But the text of their Azores agreement came close:

"The United States intends to assist in the stability of the system and the defence of the newly fixed structure of exchange rates in particular by vigorous implementation of its efforts to restore price stability and productivity."¹²⁹

The US side subsequently interpreted the "vigorous ... efforts to restore price stability" as a reference to Nixon's August 1971 price and incomes controls. Pompidou, however, interpreted it as a US promise to adopt a low-inflation macroeconomic policy and share the burden of intervention. He had good reason for this. The minutes of discussions in Summit side-meetings revealed Connally told Pompidou and Giscard d'Estaing "we would defend the dollar". Kissinger confirmed "we would have to buy dollars with other currencies in order to defend it". Pompidou agreed: "there was no other defence".¹³⁰

G10 Ministers meeting at the Smithsonian Institute

The Azores agreement led directly to the Smithsonian Agreement. G10 Ministers assembled at Washington's Smithsonian Institute on 17-18 December ready to realign exchange rates.¹³¹ The outcome closely mirrored the Azores

¹²⁹ Duncombe, *Foreign economic policy*, 597-599

¹³⁰ *Ibid.*, 605

¹³¹ The Canadian delegation was the exception. Canadian Prime Minister Trudeau visited Washington on 6 December and announced Canada would continue to float its dollar,

agreement: the dollar was devalued to \$38 per fine ounce; France and the UK held their currencies at the existing gold prices; Italy and Sweden devalued 1% against gold; the deutschemark appreciated 13.6% against the dollar, the yen by 16.9% (Table 5.1). Participants also agreed to widen the margins around par values slightly to add a little flexibility to exchange rates.¹³² The G10 also agreed to initiate international monetary reform discussions.¹³³

Table 5.1 Smithsonian Agreement: changes in national exchange rates against the dollar (%)¹³⁴	
Japan	16.88
FRG	13.58
Belgium	11.57
Netherlands	11.57
France	8.57
UK	8.57
Italy	7.49
Sweden	7.49

As promised in Rome, Connally ended the 10% import surcharge in return for the exchange rate realignment and agreement on wider currency margins; he also ceased to demand further improvements in burden-sharing arrangements. The US continued to suspend gold convertibility. Volcker

irrespective of the outcome of the G10 meeting at the Smithsonian Institute (Solomon, International monetary system, 204).

¹³² The Bretton Woods agreement permitted fluctuations within a margin plus or minus 1% around a currency's par value; the Smithsonian agreement widened this range to plus or minus 2¼%. Like the US' acceptance of dollar devaluation against gold, this represented a victory for France over US and FRG preferences. The FRG wanted a 3% margin so as to create more uncertainty in currency speculators' minds. The US wanted the wider 3% margin to enable it to push down the dollar's value against other currencies within the rules of a fixed exchange rate system.

¹³³ This agreement was expressed in general terms only. There was no specific agreement on the forum for the negotiations or the timetable.

¹³⁴ Source: Strange and Prout, International monetary relations, 343); separately, the Swiss franc appreciated 13.9% against the dollar during 1 May to mid-December 1971.

complained “(w)ith the exchange rate realignment settled and the import surcharge removed, we had little negotiating leverage.”¹³⁵

The Smithsonian Agreement appeared to depreciate the dollar by an average 10% against other G10 currencies, while they had appreciated 11%. On a trade-weighted basis, however, and including Canada’s floating dollar, the US dollar depreciated by only 7.9% against other G10 currencies, or less.¹³⁶ Connally had achieved only half of the 15% depreciation the Treasury calculated was needed to achieve his \$13 bn current account improvement target. The Agreement might be expected to generate an \$8 bn US current account improvement over a full year, including the offset agreements’ contributions. Inescapable trade lags and the boom engineered by Burns’ monetary policy implied such gains would not appear immediately. The US trade and current account balances seemed destined to worsen in 1972, and currency speculation continue. The Smithsonian Agreement appeared fragile.

Nixon, uninvited, joined G10 Finance Ministers and governors at their post-meeting press conference in the Air and Space Museum. He hailed the Smithsonian Agreement as “the greatest monetary agreement in the history of the world.” Nixon’s claim was exaggerated, but the Smithsonian Agreement was important. The G10 had demonstrated their ability to build a consensus to realign the world’s main exchange rates, an unprecedented event. Moreover, their co-operation had ended the threat of economic warfare within the Western alliance. IMF Managing Director Schweitzer praised the G10’s work and Connally’s chairmanship.¹³⁷ But retaining the US’ freedom to run inflationary domestic monetary policies for Nixon’s electoral purposes was incompatible with the new, fixed exchange rate parities. Volcker spotted the lack of commitment to the Agreement. As he listened to Nixon’s rhetoric, Volcker told a colleague he hoped the Agreement would last three months.¹³⁸

¹³⁵ Volcker and Gyohten, *Changing fortunes*, 90

¹³⁶ Excluding the Canadian dollar, the trade-weighted depreciation was 12% (Volcker and Gyohten, *Changing fortunes*, 89). This figure is not comparable with Connally’s 15% depreciation target, which was calculated inclusive of Canada. The 7.9% dollar depreciation figure was the Treasury’s estimate (see also Williamson, *Failure of world monetary reform*, 60); the Federal Reserve estimated 6.5-7.75%; the discrepancies are explained by differences in the trade weights used in the calculations (Solomon, *International monetary system*, 209).

¹³⁷ Schweitzer recalled Connally handling a sticky moment at the Smithsonian: “Finance Ministers were shut in a room until agreement was reached: Connally told them he had given them lunch but he was damned if he would give them dinner!” (Schweitzer, “Managing”, 216)

¹³⁸ Volcker and Gyohten, *Changing fortunes*, 90

Conclusions

The Smithsonian Agreement demonstrated the limits to US power and its inability to impose its will on other states using hegemony by domination tactics.

The US could wield its negative structural power successfully. Washington was able to tear up the old rules of the monetary game, suspending convertibility in August and continuing the suspension in December despite international opposition. But the US did not have sufficient positive structural power to impose new monetary, trade or burden-sharing rules unilaterally: the G10 resisted what they saw as illegitimate methods and objectives.

The US was unable to leverage its military power into achieving economic gains. Indeed, the fungibility problem became a contagion problem during August-November 1971. The US' confrontational approach to exercising economic power damaged its security alliances: fractious relations in the economic/monetary sphere spread to the security sphere, undermining Nixon's prospects of success in the Peking and Moscow summits planned for 1972. Nixon's attempt at hegemony by domination compromised US hegemony itself, costing the US legitimacy and its follower states' loyalty: they refused to follow Washington in the direction it wished to lead. US hegemony eroded, despite Washington's efforts to exploit the international monetary crisis to strengthen US hegemony. France created doubts about the US' status as monetary hegemon until Washington healed the transatlantic rift at the Smithsonian.

The Foreign Economic Policy Executive mediated external and domestic political pressures into the US foreign policy, as neoclassical realists expect. The US' "sound money" responsibilities to the international monetary order became entangled in, and subordinated to, Nixon's domestic political agenda. The latter gained priority over US security interests during August-November as Connally was unleashed. International pressures, in the shape of G10 and NATO resistance to US demands caused the Foreign Economic Policy Executive to reappraise objectives and priorities. Nixon's foreign economic policy, which had been based on prioritising US domestic political imperatives over international imperatives, was ditched as the Foreign Economic Policy

Executive returned to prioritising foreign policy objectives and responding to international pressures. This reversal was reflected in US hegemonic tactics. Co-operation and legitimacy replaced domination and confrontation as the Foreign Economic Policy Executive's preferred means of protecting US security interests and leveraging the monetary crisis into strengthening US hegemony.

Washington's shift from hegemony through domination to hegemony by consent enabled the US to provide constructive, legitimate leadership at the Rome and Smithsonian G10 meetings. Benefits followed: the US secured some absolute (and relative) gains, mainly through dollar devaluation and depreciation, and made modest progress on burden-sharing at the FRG's and Japan's expense. The US' continued unwillingness to offer trade partners reciprocal gains probably explained the US' almost complete lack of progress on trade liberalisation in 1971. As in the monetary sphere, other states' negative structural power trumped the US' ability to project its positive structural power. Co-operation had delivered benefits at the Smithsonian, but could this fragile agreement and the new mood of international co-operation last?

How has the United States Leveraged Economic Crises into its Hegemony?

A case study of the Bretton Woods Regime's Collapse and Replacement, 1969-76

Volume II (of II)

Submitted by Martin Charles Williamson, to the University of Exeter as a thesis for the degree of Doctor of Philosophy in Politics in April 2018.

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I certify that all material in this thesis which is not my own work has been identified and that no material has previously been submitted and approved for the award of a degree by this or any other university.

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Chapter 6

The Aftermath: Devaluations and Floating

“...a monetary decision must be made this weekend...we are being forced by the market”

Paul Volcker¹

“I don’t want to be in a position of making a decision on this which is good economically.”

President Nixon²

“What I am thinking about is the use of a more positive leadership role through possible intervention in order to serve our interests in keeping Europeans apart, keeping them from developing a united policy against us”.

President Nixon³

“I basically have only one view right now which is to do as much as we can to prevent a united European position without showing our hand.”

Henry Kissinger⁴

“I’m concerned about a possible effort by Nixon and Kissinger to corrupt the monetary system because of some scheme of theirs, not clearly thought through, of breaking up or at least causing difficulties for the Common Market”

Arthur Burns⁵

¹ Comment made during secret meeting with Japanese Finance Minister Aichi, 8 February 1973; secret Memorandum of Conversation, Rasmussen, Foreign economic policy, 37

² Nixon’s comment at a Quadriad meeting when faced with a choice between intervening in foreign exchange markets or permitting floating, 3 March 1973; Rasmussen, Foreign economic policy, 69

³ Nixon’s comment to Shultz and Kissinger on EEC proposals to implement a common float against the dollar, 3 March 1973; Rasmussen, Foreign economic policy, 83

⁴ Kissinger explaining to Treasury Deputy Secretary, William Simon, the administration’s decision not to intervene in foreign exchange markets were that necessary to help sustain a common EEC currency float against the dollar, 14 March 1973; Rasmussen, Foreign economic policy, 125.

⁵ Burns’ diary entry, 3 April 1973 (Burns and Ferrell, Secret diary, 95)

This chapter addresses my research question directly: how did the US attempt to leverage the international monetary crisis of 1969-76 into its hegemony? It focuses on the crisis phase triggered by a run on the dollar in the early 1973. The Smithsonian Agreement parities were overturned by market forces; encouraged by the US, G10 states adopted generalised floating exchange rates as a temporary response to the crisis. Nixon and Kissinger intended this to wreck the EEC's new monetary union, damage European integration and put the US in a strong position to impose its security agenda on Europe. I draw on the concepts and definitions discussed in chapters 1-3 and return to the debate aired in the literature review in chapter 2: were the US' actions driven by strength or weakness? Whereas scholars engaging in this debate were previously obliged to seek their evidence mainly in secondary sources, I draw on materials now available in British and US archives. These present a new, completely original picture of why the US acted as it did.

The archived documents yield much original material. This challenges what scholars thought they knew about the introduction of generalised floating exchange rates. I will demonstrate the central debate on this issue - between scholars who argue changes to the international monetary order were brought about either by hegemonic strength or weakness - misses the point. Generalised floating was not adopted because there was a concentration of power in the US, nor a deconcentration. Archives show Nixon and Kissinger regarded the introduction of floating exchange rates as simply a (short-term) means to an end. They had two objectives: first, destroy Europe's new monetary union and damage European integration without being blamed; and second, impose the US' security agenda on a weakened and divided Western Europe. If, as Nixon and Kissinger believed, the world was in transition from bipolarity to multipolarity, then the EEC would soon emerge as a rival to the US. Nixon and Kissinger wanted to weaken EEC cohesion and subject EEC states to divide and rule tactics in pursuit of US objectives on security topics. Archived documents show the US pushed for generalised floating for political and security reasons, not economic reasons.

The US, after using hegemony by consent tactics in 1972, returned to deploying hegemony through domination tactics in 1973. In doing so, archives

reveal, Nixon and Kissinger had no intention of creating a new international monetary order based on floating exchange rates and free capital mobility as Strange's structural Realist followers and some Marxists claimed. They gave no thought to establishing new economic structures and a neoliberal future for the world economy. Creating a new monetary order was a task delegated to Shultz and Volcker in the C20 (discussed in chapter 7). But that could wait, as far as Nixon and Kissinger were concerned. Their priority was to strengthen US security and hegemony by smashing European monetary union and its political unity, reducing the risk of Europe either opposing US security interests or creating its own currency bloc to rival the dollar in a multipolar world.

In luring Europe into generalised floating, Washington intended to create political havoc in the EEC, but no lasting damage to the international monetary order. It was a gamble Washington could afford to take. Nixon and Kissinger were confident Shultz and Volcker would pick up the pieces in the C20 and create a new fixed exchange rate-based international monetary order in line with US preferences. US success in the C20 would ensure generalised floating was only a temporary monetary aberration, but one that would cause lasting political damage to European integration and strengthen US hegemony.

This chapter is organised into six sections covering: a review of international relations scholars' analysis of the introduction of generalised floating; Foreign Economic Policy Executive personnel changes; the structural and systemic developments in 1972 that helped undermine the Smithsonian Agreement's exchange rates; dollar devaluation in February 1973; adoption of generalised floating in March 1973; and conclusions.

Scholars' Analysis of the Move to Floating Exchange Rates

The "Nixon Shock" of August 1971 was of greater interest to international relations scholars than generalised floating's adoption in 1973. Of the 74 publications in the literature review discussing Nixon closing the gold window, less than half also discussed the move to generalised floating in 1973 (Table

6.1).⁶ Of these, several simply mention floating as if it were a logical or inevitable consequence of Nixon's decision to suspend convertibility.

Table 6.1 Selected authors' views on the causes of the adoption of floating, 1973			
Causes	Realists	Liberals	Marxist
Hegemonic weakness	Gilpin (1987) Krasner (1977) Webb & Krasner (1989)	Cohen (1977) Gilbert (1980) Keohane (2005)	
"Structural power"/hegemonic strength	Calleo & Strange (1984) Guzzini (1998) Kunz (1997) Mastanduno (2009) Seabrooke (2001) Strange (1986)	Bergsten (1975) Eichengreen (2008, 2012) Moffitt (1983)	Gowan (1999) Konings (2009) Panitch & Gindin (2012)
Other	Kindleberger & Aliber (2005) Schmitt (1974) Sterling-Folker (2002)	De Vries (1976) Gray (2007) Odell (1979) Nau (1992) Solomon (1977) Williamson (1977)	D'Arista (2009)

Scholars devoting substantive attention to the G10's decision to adopt generalised floating divide into three camps. The majority take the view this was part of a process in which the US used its structural power (or a similar concept) to re-write international monetary rules in its favour in 1971-73, aiming to constrain other states to behave in ways Washington and Wall Street wanted.⁷ Strange was an early advocate of this explanation. Her analysis had widespread appeal: many scholars followed her lead, including members of the Realist, Liberal and Marxist traditions. A second group attribute generalised floating to US hegemonic weakness. They argued the decline first showed itself in the US' inability to maintain gold convertibility and the Bretton Woods regime in 1971, culminating in the US being unable to maintain the dollar's fixed

⁶ See Table 2.1, chapter 2 above

⁷ Strange's concept of structural power is used by other scholars adopting different terminology. Moffitt, for example, attributed the US' ability to force change to "the power of the dollar" in international economic affairs (Moffitt, *World's money*, 40).

exchange rate in 1973 against growing German and Japanese economic power. This hypothesis is associated with Liberal scholars, including Keohane and Cohen, but also attracted Realists, including Gilpin and Krasner. Marxist theorists, especially World System theorists, tend to support this view.⁸ A third, diverse, group identify numerous causes, including US domestic political factors, Bretton Woods' technical defects or other economic causes, notably the growing influence of financial markets.⁹

Despite scholars' efforts to analyse the causes of generalised floating's adoption, it is striking none appear to have used the now-available archived materials on decision-making in the US and abroad. Sterling-Folker, for example, refers to the Volcker Group's deliberations when discussing events from her neoclassical realist perspective, but she did not make use of the Group's archived documents or of White House tapes recording the Foreign Economic Policy Executive members' discussions.¹⁰ Archived materials were of course inaccessible to those writing shortly after the events occurred: official papers are not released instantly. Partly to compensate for this, scholars used published materials, including memoirs and contemporary diaries of policymakers and senior officials; and some scholars, such as Odell, had the privilege of interviewing leading participants.¹¹ But participants' publications and their memoirs are subject to familiar limitations.¹² Archived documents and

⁸ Several World System theorists, including Arrighi and Wallerstein, skip over the introduction of floating as a mere detail in a broader picture of US decline: I therefore exclude them from table 6.1.

⁹ For example, de Vries, "Non-reform of the international monetary system", Gray, "Floating the system", Odell, "Emergence of flexible exchange rates", Solomon, *International monetary system*, and Williamson, *Failure of world monetary reform*, attributed the adoption of floating mainly to economic factors; Nau, *Myth of America's decline*, and Sterling-Folker, *Theories of international co-operation*, saw it as the result of the mediation of international pressures through domestic politics.

¹⁰ See her discussion in Sterling-Folker, *Theories of international co-operation*

¹¹ Odell's "Emergence of flexible exchange rates" is based primarily on information gathered in interviews.

¹² Success has many fathers and policymakers are probably as prone to over-claim credit for a favourable outcome as practitioners in other fields. Burns, for example, was the only member of the Foreign Economic Policy Executive to record and publish what others had missed or chose to omit. His diary entry for 3 April 1973, which covered the Quadriad meeting on the morning of 3 March and subsequent meetings that day, recorded that both he and Shultz were worried about Nixon and Kissinger's intentions: "I'm concerned about (a) possible later effort by Nixon and Kissinger to corrupt the (international) monetary system because of some scheme of theirs, not clearly thought through, of breaking up – or at least causing difficulties for – the Common Market" (Burns and Ferrell, *Secret diary*, 95). The "scheme" to which Burns referred turned out to be generalised floating. In another example of questionable recollection, Connally claimed in his memoirs he was in favour of adopting a floating exchange rate system from September 1971: "I agreed with George Shultz. In the first Group of Ten meeting in London...I tried out the idea of floating exchange rates. I got no support" (Connally and

the White House tapes tell a somewhat different tale, and arguably do so more reliably than political memoirs.

The archived materials reveal problems with the generally accepted version of events, be it found in the scholastic literature or participants' memoirs.¹³ It is widely accepted, for example, that the pro-market, pro-floating Shultz gave the nod to European states adopting a common float at an augmented G10 meeting in Paris in March 1973 (effectively ending the fixed exchange rate system).¹⁴ It will be shown below, however, it was Kissinger who gave the green light to floating in a secret telephone conversation with FRG Finance Minister Schmidt more than a week before Shultz blessed generalised floating at the G10 meeting.¹⁵ Kissinger involved himself because he wished to bait a trap for European states; his ultimate aim was to disrupt European integration, sow discord in the EEC and profit from this in international security and Year of Europe negotiations. I am not aware of any other study drawing attention to this. The point is significant because it helps explain how and why political factors of interest to Nixon and Kissinger drove the adoption of floating, not the economic factors preoccupying Shultz.

Herkowitz, *In history's shadow*, 237). Archived material and other evidence does not support this claim. Robert Solomon, who had the opportunity to observe Connally closely during 1971-72, believed Connally "was less concerned with the issue of floating versus fixed (exchange) rates than with what he called 'fair' rates" (Solomon, *International monetary system*, 213). Similarly Kissinger claimed after the event "It took us nearly two years to get a fully floating exchange rate system accepted by our allies", as if this had been US policy since August 1971 (Kissinger, *White House years*, 956). It was not, as will be demonstrated below and in chapter 7. But such statements perhaps helped mislead scholars unable to access the archived material.

¹³ See, for example, Volcker in Volcker and Gyohten, *Changing fortunes*, 112-13. Dam, Deputy Director of OMB, recalls "Floating was not chosen as a system. It originated in a confused period between the closing of the gold window in 1971 and the beginning of generalised floating in 1973" (Dam, *Rules of the global game*, 194). This could be read as a hint that non-economic factors intervened, but a more plausible explanation of his comment is that all states participating in the decision to introduce generalised floating in March 1973 believed this was a short-term expedient the C20 would soon replace with a comprehensively reformed international monetary order based on fixed exchange rates. Generalised floating was not widely accepted as offering a long-term solution. Volcker (in Volcker and Gyohten, *Changing fortunes*, 113) took this view, as did Shultz (in Shultz and Dam, *Economic policy*, 128). Volcker's memoirs give a prominent role to Schultz in negotiating the introduction of generalised floating. CEA chairman Stein mentioned generalised floating's adoption and its consequences, but did not discuss its causes (Stein, *Presidential economics*, 195). Nixon, in *Memoirs*, and Kissinger (in Kissinger, *White House years*, and *Years of upheaval*) did not discuss the adoption of generalised floating.

¹⁴ Wells provides a typical, if somewhat compressed, account: "George Shultz proposed that currency values be left to float in the market place. The other members of the G10 accepted this..." (Wells, *Economist in an uncertain world*, 108).

¹⁵ The conversation was recorded on one of the White House tapes.

Kissinger's prominent role, as revealed in the US archives (but not his memoirs or scholars' accounts), confirms the move to generalised floating was not rooted in US economic structural power, despite the many claims for this.¹⁶ Kissinger had little interest in economics.¹⁷ Neither he nor Nixon intended to create a new international structure in the form of a new international monetary order based on floating exchange rates. Like Shultz, Burns and Volcker, they expected the C20 to create a new, fixed exchange rate-based international monetary order. The floating exchange rates operating today came about more by accident than, as structural power theorists would have it, by US design.

Foreign Economic Policy Executive Changes

McCracken's and Connally's departures triggered Foreign Economic Policy Executive changes in 1972. McCracken's "gradualist" macroeconomic policy had failed, causing Nixon to mistrust and ignore him. The disheartened CEA chairman resigned in December 1971. Herbert Stein, promoted from within the CEA, replaced him. Stein and McCracken were both from the mid-West and the same ideological mould: pro-market, but not to Friedmanite extremes. Stein, an expert on domestic fiscal policy, was a Nixon loyalist.¹⁸

Connally's resignation on 16 May 1972 was more significant. He disliked the Smithsonian Agreement outcome and had no appetite for international monetary reform. He dragged his heels on reform during January-May 1972 before returning to domestic politics, where he established the "Democrats for Nixon" organisation and prepared himself for possible selection as Nixon's second term Secretary of State, or even his Vice President.¹⁹

¹⁶ See, for example, Strange, *Casino capitalism*, Bergsten, *Dilemmas of the dollar*, and Gowan, *Global gamble*.

¹⁷ Kissinger met Kakuei Tanaka on 12 June 1972 when the latter was the minister in charge of Japan's MITI. Seeking to turn discussion away from the economics that occupied Tanaka, Kissinger told him "... economics is not a field I usually address in great detail. ... My major interest in economics is to make sure it does not disturb foreign policy." (Duncombe, *Foreign economic policy*, 249)

¹⁸ Nixon, describing his final meeting with White House staff in 1974, praised Stein: "... a man I always respected for his cool and analytical intellectual ability and his dry sense of humour, (stood) with tears streaming down his face" (Nixon, *Memoirs*, 1088).

¹⁹ Haldeman diary entry for 22 April 1972 recorded Connally agreeing to form a "Democrats for Nixon" lobby "when it would do most good" (Haldeman, *Diaries*, 444).

Shultz replaced Connally at the Treasury.²⁰ Connally had been well-fitted for implementing a strategy of hegemony by domination. He was a neomercantilist Realist on economic matters, but the political winds had turned: Nixon needed a consensus-builder, not a consensus-buster. Moreover, Connally sometimes struggled with his administrative tasks because he was unwilling to share his thinking or delegate tasks.²¹ Shultz was the opposite. He personified the administration's new strategy of hegemony by consensus. Shultz's long experience as a labour negotiator had instilled in him an instinct to search for consensus which over-rode his Friedmanite, free market liberal ideology; this equipped him for the task of building a consensus-based legitimate international monetary order.²² Shultz's strong bureaucratic and administrative skills soon enabled him to extend his influence beyond the Treasury. Nixon regarded Shultz as "one of the ablest members of the Cabinet".²³ When Nixon reorganised and consolidated various Cabinet responsibilities at the start of his second term in January 1973, he gave Shultz the enhanced role of "Economy Czar".²⁴

Caspar Weinberger, known as "Cap-the-Knife" for his budget-cutting skills, stepped up from OMB Deputy Director to replace Shultz as Director in May 1972 until he was replaced by Roy Ash in February 1973. Ash served as OMB Director until February 1975. The Troika, now comprised Shultz, Stern and Weinberger (later Ash); the Quadriad, comprised the Troika plus Burns.

Haldeman also recorded Connally launching the "Democrats for Nixon" organisation on 9 August 1972 (Haldeman, Diaries, 491).

Haldeman's diary entry for 12 June 1972 shows Nixon offered Connally the chance of becoming Vice President or Secretary of State; Connally said he would prefer to be the Secretary of State (Haldeman, Diaries, 470).

²⁰ He was sworn in on 12 June 1972 after a brief period as Acting Treasury Secretary.

²¹ On learning Connally had told Nixon he planned to resign in January 1972, Shultz told Haldeman on 19 January 1972 he was concerned about Connally's methods of operation: "disconnected from the President... (overloaded with work but with) no staff and no time to do it... Connally doesn't consult, he operates" (Haldeman, Diaries, 399). Haldeman agreed Connally did not delegate, recording in his diary on 18 April 1972 "(Connally) wants to control everything that affects him, he will not allow others to make decisions for him and especially he will not allow staff people whose judgement isn't as good as his to do so" (Ibid., 441).

²² Burns and Kissinger discussed Shultz's appointment in July 1972. Burns commented: "When Shultz got in (as Labour Secretary) I was very negative. He did not know much about this (i.e. economic policy). Before he was difficult to deal with, very theoretical. Now he thinks more pragmatically." Kissinger replied "I was concerned he was too doctrinaire ..." but agreed Shultz was now proving effective in the Treasury (confidential Memorandum of Conversation, 22 July 1972; Duncombe, Foreign economic policy, 639-43).

²³ Nixon, Memoirs, 908

²⁴ Nixon appointed Shultz not only Treasury Secretary, but also head of Economic Affairs and Counsellor to the President (Ibid., 767).

The changes shrank the Foreign Economic Policy Executive from seven to five members: Nixon, Burns, Shultz, Volcker and Kissinger. Official records reveal Stein, Weinberger and Ash exerted little influence over foreign economic affairs, concentrating on domestic issues. The Volcker Group was reshaped and re-named the “Shultz Group”, although Volcker continued to chair it most of the time. The Group’s composition changed, however, partly of necessity as Stein replaced McCracken, and partly because Shultz wanted a more inclusive Group than had been possible (or required) by Connally. Secretary of State Rogers joined the Group, as did Peter Flanigan, the pro-market, pro-floating exchange rate White House aide who had replaced Peterson as Executive Director of the Council for International Economic Policy.²⁵

Structural and Systemic Developments in 1972

The Smithsonian Agreement profoundly changed the international monetary order, but not the international monetary system, nor the evolution of the structural pressures on it.²⁶ G10 states had undergone a searing international monetary experience in 1971. They seemingly breathed a sigh of relief on achieving the Smithsonian Agreement and ignored the risks of repeating 1971’s crisis by returning to their previous behaviours and accepting the international structural conditions that had brought it about.²⁷

²⁵ Flanigan had previously served in the White House as Assistant to the President during 1969-71. Derek Mitchell, an HM Treasury official posted to the British Embassy in Washington, reported to London on a conversation with Flanigan in a letter dated 11 July 1972. Mitchell observed Flanigan’s experience of working on Wall Street had made him philosophically inclined towards seeking free market solutions to international monetary problems “and therefore (attracted) by a universal regime of floating.” (Bank of England archive file OV 53/43)

²⁶ As outlined in chapter 1, an international order reflects the norms, principles, rules and decision-making procedures states have agreed upon. This “constitution” is given life by states’ behaviours, which in aggregate comprise an international system. States’ behaviours are shaped by a combination of structural factors - which establish states’ expectations and impose behavioural imperatives on them - and the international order’s design - which sets expectations as to what is and is not legitimate behaviour.

²⁷ Volcker’s pessimistic assessment of the Smithsonian Agreement’s prospects (it lasting only 3 months) is evidence of these risks being visible at the time. Volcker pinpointed states’ lack of commitment to making the new arrangements work as the Smithsonian Agreement’s major weakness. From his Japanese perspective, Gyohten identified two more likely causes of failure: first, states had behaved selfishly at the Smithsonian, bargaining primarily to achieve an exchange rate that protected their commercial interests, but none had addressed the need for “fundamental” reform of the order and what that might look like; second, “...it was impossible to hope for a return to a fixed-rate system based on the dollar because the

The international monetary order had been transformed from the Bretton Woods regime's gold-exchange standard to a dollar standard when Nixon unilaterally suspended other states' right to convert their officially-held dollars into US gold. The US resisted other states' efforts to persuade it to reopen the gold window and subject itself to this crucial monetary discipline; the dollar standard therefore remained in place in 1972.²⁸ One might have expected states' behaviours to change as the international monetary order changed. They did not, with one notable exception: Britain floated sterling. The main structural changes evident in 1971 - the slow transfer of relative economic power from the US to Europe and Japan, and the growth of the Eurodollar market's power relative to national central banks - also continued unchecked in 1972, again with one notable exception: the EEC created its first monetary union, potentially a currency bloc to rival the US dollar's hegemony.

European monetary union

EEC states wanted to pursue economic integration and strengthen their hand against market forces by forming a monetary union. The EEC's initial plan to introduce monetary union on 15 June 1971 was scuppered when the FRG floated the deutschemark in May 1971 in response to a foreign exchange market crisis.²⁹ Monetary union eventually went ahead on 24 April 1972, based on the Werner Plan's "snake in the tunnel" mechanism.³⁰ EEC states

dollar did not recover its credibility" (Volcker and Gyohten, *Changing fortunes*, 99). The dollar's credibility was prejudiced, Gyohten believed, by US unwillingness to intervene to defend the dollar's value and by the Federal Reserve pursuing an expansionary monetary policy without regard to the implications for the international monetary order's stability. Volcker attempted to justify the US' position after the event, claiming "... it was generally understood that the United States would not be prepared to defend the new exchange rates with its own gold or by borrowing foreign currencies" (Ibid., 90). That was not France's understanding, following the assurances Pompidou received at the Franco-American discussions in the Azores, and therefore not Europe's understanding either (see chapter 5).

²⁸ Volcker observed the Smithsonian agreement simply validated a dollar standard: "Bretton Woods without the gold" (Volcker and Gyohten, *Changing fortunes*, 90). See also Coombs, *Arena of international finance*, 225.

²⁹ On 22 March 1971 EEC Finance Ministers committed themselves to narrowing the margins of fluctuations between EEC currencies from the +/- 1% then permitted by the Bretton Woods agreement to 0.6%, to be implemented as of 15 June 1971 (Gray, *Floating the system*, 306-11).

³⁰ This system was recommended to the EEC by a Committee chaired by Luxembourg's Prime Minister, Pierre Werner, on 8 October 1970 (*Report to the Council and the Commission on the realization by stages of economic and monetary union in the Community*; Council-

committed themselves to keeping their currency fluctuations within a 2¼% band above or below each currency's Smithsonian central rate (the so-called "snake"), thus permitting movements of no more than 4½% in total against other member currencies (the diameter of the "tunnel"). Participating currencies could move to this very limited extent up or down against each other, resembling the wriggling of a snake within a tunnel, hence the system's name. This was tighter than the G10 commitments in the Smithsonian agreement.³¹ Participating central banks were to use EEC currencies, not US dollars, for intervention purposes to defend rates within the tunnel. With the UK close to EEC accession, sterling joined the snake on 24 May.³²

Foreign exchange markets gave neither the Smithsonian central rates (parities) nor the EEC's snake an easy ride.³³ Markets boiled up in March. They were calmed only when Connally and Bundesbank Vice-President

Commission of the European Communities, Luxembourg 1970). It was endorsed by EEC Finance Ministers in March 1971. The Werner Plan envisaged permanently locking EEC exchange rates against each other after implementing various monetary unification measures (including fiscal harmonisation) over a three-stage transitional period. The first stage required EEC members to co-ordinate their monetary policies and limit exchange rate movements against each other's currencies (hence the snake within the 4½% tunnel). This was intended to be implemented during 1971-72, but the original timetable was disrupted by foreign exchange market crises. The second stage required exchange rate variability to be reduced further before being "irrevocably fixed" in Stage 3, when the EEC would also create its unified system of central banks. Further details can be found in Eichengreen's "European monetary union", 1321-23, and his "Exorbitant privilege", 75; and in Heath, *Course of my life*, 375, for further details.

³¹ Under the Smithsonian agreement an exchange rate could move within a 4½% band (i.e. 2¼% either side of its central parity) and exchange rates between two currencies could in theory move by a maximum total of 9%. This would require one currency to move from the top of its 4½% band to the bottom, while the other currency moved from the bottom of its band to the top. This would create a combined swing of 9% of one currency against the other, although each would remain within the bands permitted by the Smithsonian agreement. The Werner Plan created bands for snake-member currencies that were only 2¼% wide, thus limiting the maximum movement of one snake-member currency against the others to 4½%.

³² The Bank of England had strong misgivings. Miss G. Gardner, an economist in the Bank of England's Economic Analysis and Research Group, commented on 20 April 1972 on the Werner Plan's forthcoming implementation "In order for this exchange rate stability to succeed without creating internal imbalances between member states and between regions, much of the economic autonomy of the present Community must give way to more centralised decision-making." This was, of course, precisely what the Plan lacked largely because France opposed Euro-federalism. (Bank of England archive file 6A 213/1)

³³ Burns warned Kissinger and Hormats that "foreign central banks" had taken in \$6 bn in six months; Secret Memorandum of Conversation, 25 July 1972 (Duncombe, Foreign economic policy, 640). Solomon clarified the point, noting these were *European* central banks (Solomon, *International monetary system*, 223). These dollar inflows were a sign of markets' continued doubts about the Smithsonian exchange rates. The FRG's handling of its share of these inflows led to a desperate Bundesbank calling for the FRG government to introduce capital controls. When the Cabinet discussed this in late June and sided with the Bundesbank's recommendation against Schiller's preference for floating, the latter resigned and was replaced by Schmidt. This cost the US an important ally in European financial circles. The FRG closed its capital markets as dollars flowed in on 26 June. The FRG Cabinet's measures were half-hearted and ineffective, however, being limited to prohibiting bond sales to foreigners; France, meanwhile, continued to operate draconian controls to defend the franc's exchange rate.

Emminger (at the Council on Foreign Relations on 15 May) and Burns (at the BIS) gave speeches reassuring markets G10 states would defend their Smithsonian exchange rates. Emminger's speech was especially effective. He was upbeat about the Smithsonian Agreement.³⁴ It was, in his view, "generally considered a fair one". He argued the realigned exchange rates were close to those recommended by OECD and IMF experts; the US import surcharge had been removed immediately; all had recognised the US' need to adjust; and the experience with floating exchange rates in 1971 had been "sobering". Emminger declared "the Smithsonian realignment is worth defending and will be defended". Markets calmed temporarily, then focussed on sterling in June.

Sterling floated

Sterling came under speculative pressure in June 1972, almost as soon as it joined the EEC's snake, because the UK's commitment lacked credibility.³⁵ Prime Minister Heath defended sterling's Smithsonian exchange rate briefly, spending one third of Britain's reserves.³⁶ But he raised interest rates by only one percentage point - a disjointed and half-hearted defence. His government had no stomach for the fight.³⁷ Heath authorised "temporary floatation" on 21 June, a mere four days after speculation had begun.³⁸

This episode revealed the radical change in G10 governments' attitudes towards fixed exchange rates.³⁹ Informed by their experience of floating during

³⁴ Otmar Emminger's remarks to the Corporate Services Seminar held at the Council on Foreign Relations on 15 May 1972. (Bank of England archive file OV/53/42)

³⁵ The UK's inflation was relatively high, labour relations were problematic and the costs of EEC membership were expected to weaken the UK's balance of payments from 1 January 1973.

³⁶ Heath agreed to spend \$2.6bn of Britain's \$7.9bn of reserves. Heath provided these figures (a significantly higher reserve loss figure than he mentioned in his published autobiography) when he wrote to Brandt on 23 June 1972 to explain the UK's decision to float and leave the EEC's currency snake (Gray, *Floating the system*, 316).

³⁷ Heath recalled: "The pound had been allowed a degree of freedom in autumn 1971, when President Nixon suspended dollar convertibility and ... (w)e were by no means dogmatically attached to the principle of fixed exchange rates..." (Heath, *Course of my life*, 409)

³⁸ Heath (*Ibid.*, 410). Pre-accession Denmark also left the snake with the UK.

³⁹ Harold Wilson contrasted his government's draining experience of defending sterling's fixed exchange rate for three years (1964-67) before conceding a "cataclysmic" devaluation with Heath's experience. Wilson commented: "The Conservatives devalued at will (in 1972) and not a dog barked" (Wilson, *The Labour government*, 3). Volcker recalled British Chancellor Anthony Barber telling him that recent monetary developments (i.e. August-December 1971) had taught him "not to wait too long to change an exchange rate if balance of

August-December 1971, aware that most states' trade and investment had not been endangered by floating, and confident international capital and foreign exchange markets would cope with floating exchange rates, the British (and others) were unwilling to pay a large price to sustain a fixed exchange rate.

This Smithsonian breach surprised the US Treasury, but failed to reignite Nixon's interest in international monetary affairs.⁴⁰ Burns, concerned about contagion risks for the lira, told Haldeman to warn Nixon. The president, possibly still brooding on a briefing about the Watergate break-in earlier that day, cut short Haldeman's efforts, snapping "I don't give a shit about the lira".⁴¹

Other developments in 1972

The structural changes underway before Nixon closed the gold window - the type of gradual changes Gilpin factored into his dynamic model of hegemony - continued in 1972: relative economic power slowly shifted from the US to Europe and Japan; and the Eurodollar market gained deposits, increasing its power to disrupt central banks' management of fixed exchange rates.⁴² States' systemic behaviours also continued much as before the Smithsonian Agreement, feeding into the structural changes without really adjusting to them:

- Nixon continued to demand Burns should expand the money supply to create an economic boom for the 1972 presidential election.⁴³ Under

payments trends were adverse and the exchange rate came under pressure" (Volcker and Gyohten, *Changing fortunes*, 104-05).

⁴⁰ Volcker and Gyohten, *Changing fortunes*, 105

⁴¹ Silber, Volcker, 110, quoting from the White House tapes of 23 June 1972.

⁴² Gilpin, *War and change*

⁴³ For example, the White House tapes - quoted by Abrams, *How President Nixon pressured Arthur Burns*, 183 - include a record of a conversation between Nixon, Shultz and Ehrlichman on 14 February 1972. They discussed economic prospects and monetary policy in 1972. Shultz pushed the president to put more pressure on Burns, despite the external consequences: "The economy *has* to be good, (a) strong expanding economy this year. So much depends on that. He (Burns) recognises that and he needs to do everything he can do... We want low interest rates. What's the problem there? So, we don't have a return flow of money from Europe? So what? Keep the money supply going up!" Nixon telephoned Burns later that day to urge further monetary expansion.

Nixon wanted to fine tune and synchronise the US economy's business cycle to his "political cycle". He had originally intended his fiscal policy, like monetary policy, to be expansionary in 1972: a "belt and braces" approach to guaranteeing an economic boom in time for the presidential election. In January 1972 he urged his Cabinet to spend their departmental budgets fully (Stein, *Presidential economics*, 184). Nixon switched to a conservative fiscal policy, however, once he knew his election opponent would be McGovern. Nixon painted

White House pressure (Nixon was refusing to accept Burns' nominations for the Federal Reserve Board at the time), Burns cut interest rates.⁴⁴ An already inflated broad money supply grew almost 13% in 1972, bringing the total increase to more than 25% in Burns' first two years at the Federal Reserve (Table 6.2). This far exceeded the amount of money the US public wished to hold. Many of the dollars spilled abroad in search of better interest rates. Foreign central banks' dollar reserves increased 22%;⁴⁵

- US monetary laxity also fed the Eurodollar market, where net deposits increased 28% in 1972, boosting the market's power relative to central banks. June's sterling crisis demonstrated the power of market forces;⁴⁶
- the US economy boomed as Nixon had hoped, but so did US imports. The trade and current account deficits worsened despite the Smithsonian Agreement's fillip to US competitiveness. The US was further away from covering the foreign exchange costs of Washington's power projection policies in 1972 than when Nixon closed the gold window;
- despite US promises to Pompidou at the Azores Summit, the US refused to support Smithsonian Agreement exchange rates through intervention, leaving their defence to other states' central banks.⁴⁷ The US made just

McGovern as a spendthrift Democrat and sought to differentiate himself in voters' eyes by stressing his own fiscal prudence. His administration's budgets were not fully spent (*Ibid.*, 188); the Federal budget deficit outturn (1% of GNP in 1972) undershot its original target and was lower than 1971's deficit (Table 6.2). This unplanned fiscal rectitude put the burden of achieving economic expansion entirely on monetary policy, precisely the area in which US macroeconomic policy would most damage the Smithsonian Agreement's fixed exchange rates.

⁴⁴ Abrams, How President Nixon pressured Arthur Burns, 182

⁴⁵ IMF *International Financial Statistics* 1975

⁴⁶ Strange, International political economy, 96

⁴⁷ France scolded the US when it became apparent the assurance Nixon, Connally and Kissinger had given Pompidou in the Azores meant nothing. On 4 February President Pompidou wrote a curt letter to Nixon - it had to be "sanitised" before being shown to Connally - complaining the US was not living up to what had been agreed in the Azores. Pompidou observed the US had not tightened its macroeconomic policies, as was required in the French president's opinion to bring US inflation under control. Nor was the US joining with other G10 central banks in intervening in foreign exchange markets to stabilise the dollar. The annoyed Pompidou instructed Nixon to send him the administration's plans for implementing the US' commitment to devalue the dollar (Unclassified Letter from President Pompidou to President Nixon, 4 February 1972; Duncombe, Foreign economic policy, 604-07). This calculated insult highlighted Pompidou's lack of faith in Nixon's promises.

Nixon's responded evasively in a letter sent on 16 February. He claimed the US would honour its commitment to defend the dollar and intervene, but only when a reformed international monetary system was in place. Nixon claimed he did not regard the US commitments made in the Azores as binding under current monetary arrangements (Secret Letter from President Nixon to President Pompidou, 16 February 1972; Duncombe, Foreign economic policy, 608-11).

one exception in 1972, intervening for one day only.⁴⁸ The apparent resumption of Nixon's "benign neglect" of the dollar caused great concern in Europe;⁴⁹

Giscard d'Estaing followed up Pompidou's complaint, threatening to end France's "monetary truce" with the US unless Washington took steps to limit US short-term capital outflows (Solomon, *International monetary system*, 218). US Ambassador Watson reported from Paris officials' and media analysts' repeated criticisms of Connally's resumption of procrastination. They were irritated by Connally's unwillingness to restore convertibility and his refusal to initiate the promised discussion of international monetary reform, or even agree the forum in which such discussions would take place. In their opinion, the US had returned to its policy of "benign neglect" of the dollar (Telegram from US Embassy in Paris to Department of State, 11 March 1972; Duncombe, *Foreign economic policy*, 613). Watson recommended the US act to counter the impression of US indifference to the dollar's fate.

The Federal Reserve could, in theory, expand the US money supply without limit, while other states wishing to maintain fixed exchange rates would have to absorb the excess dollars, losing control of their domestic monetary and anti-inflation policies. Congress, at Nixon's request, could have eased the intervention burden on other states by instructing the Federal Reserve to share the burden with them. But this would have required the US either to borrow the necessary foreign currency (requiring Congress' approval) or to activate the 1960s short-term swap arrangements between G10 central banks. Either tactic would have created political and economic risks and costs Nixon was unwilling to accept. Volcker commented on Nixon's reluctance to defend the exchange rates he had praised at the Smithsonian G10 meeting: "I saw no evidence that the White House was any more committed to preserving the Smithsonian exchange rates (than was the Federal Reserve)" and "... despite (Burns') enthusiastic support of fixed exchange rates, he seemed to me to have a kind of blind spot when it came to supporting them with concrete policies" (Volcker and Gyohten, *Changing fortunes*, 104).

⁴⁸ The one exception to the US' "non-intervention" rule in 1972 reflected the newly-appointed Shultz's wish to establish good relations with his FRG counterpart, Helmut Schmidt.

Shultz replaced Connally as Treasury Secretary in mid-May. A potentially tricky visit by Schmidt was imminent. Schmidt (SPD) and Schiller (CDU) had been part of the FRG's "Grand Coalition" government until Schiller abruptly resigned from his post as Economics and Finance Minister on 6 July 1972; Schmidt replaced him. Both men supported a policy of sustaining the FRG's alliances with the US and France, but Schiller tended to favour the US alliance, while Schmidt favoured France to a greater extent (Gray, *floating the system*, 313-17). Schiller was also thought to be more concerned with economic efficiency than Schmidt, floating the deutschemark in response to foreign exchange market pressures in 1969 and again in May 1971 rather than introducing capital controls. Schiller regarded capital controls as both inefficient and a return to Nazi policies. Schmidt was less concerned with efficiency, taking a more geopolitical view of his policy options as Finance Minister. He thought adopting French-style capital controls in the FRG would: help build relations with France; sustain a fixed exchange rate; and develop EEC economic and monetary union. Schmidt arrived in Washington on 20 July to warn the US he was prepared to introduce capital controls if the Nixon administration failed to defend the Smithsonian parities.

Shultz wanted to demonstrate his post-Connally less abrasive approach to international financial diplomacy and give Schmidt reasons to support US policy over French or EEC international monetary policy. The rest of the G10 had criticised the US for free riding on the Smithsonian Agreement when Burns cut US interest rates in February 1972 and the US Treasury refused to intervene to defend the Smithsonian exchange rates. Shultz saw this as an area in which he could make his mark quickly and cheaply to smooth relations with Schmidt. He put an options paper to Nixon requesting approval for intervention, which Nixon agreed (Confidential Memorandum from Secretary of the Treasury to President Nixon; Duncombe, *Foreign economic policy*, 631-34. This was undated, but probably sent to Nixon for decision on 18 July 1972). Shultz immediately sprang his surprise on markets, authorising the Federal Reserve to spend \$50m to defend the dollar on 19 July. In the event they had to spend only \$30m. This was a relatively cheap, but entirely successful operation, lasting only one day. Shultz's welcoming gift to Schmidt of a small US intervention was the perfect way to ease FRG/US tensions. On his arrival in Washington the following day, Schmidt duly praised the US' change of tack; the bilateral discussions got off to a good start. The intervention also delighted Burns (Secret Memorandum of Conversation, 25 July 1972; Duncombe, *Foreign economic*

- growing Japanese and FRG trade and current account surpluses were the counterpart to US deficits, marking a further growth of their economic power relative to the US';⁵⁰
- Europe and Japan continued to resist US efforts to create a new international institution in which to discuss and co-ordinate international

policy, 640) and Coombs, who implemented the intervention (Coombs, Arena of international finance, 225). It quietened markets (and the G10) for the remainder of the year.

⁴⁹ The well-connected Belgian economist and Director of the Banque de Bruxelles, Alexandre Lamfalussy, told a *Financial Times* conference the Smithsonian agreement had engineered dollar devaluation, but had not locked in appropriate domestic economic policy changes to prevent continued US inflation; in Lamfalussy's opinion, Europe had thrown away its cards (Lamfalussy's speech to the "New Currency Solutions" conference organised by the *Financial Times* on 23 February 1972; Bank of England archive file OV/53/42). Edwin Stopper, chairman of the Swiss National Bank, warned the US had given priority to its own economic recovery since suspending convertibility; its post-Smithsonian continuation of "cheap money" and deficit spending "gives rise to doubts as to whether the Americans are serious about restoring the balance of payments and undertaking monetary reform" (Remarks by Dr Stopper to the National Bank of Switzerland's annual general meeting on 24 April 1972; Bank of England archive file OV/53/42). On 12 May 1972 Dutch Ministry of Finance officials (Mr. Oort and Mr. Looyen) told their UK Treasury counterparts (Neale and Littler) they were worried by the volume of dollars spewing out of the US and the consequent growth of the dollar overhang, which they estimated at \$60 bn (Bank of England archive file OV/53/42).

The Nixon administration tolerated Europeans grumbling among themselves, but found itself under real pressure when Helmut Schmidt, FRG Minister of Economy and Finance, complained directly to Washington. In a secret meeting with Kissinger (Kissinger's secret Information Memorandum for the Record of his conversation with Schmidt, 20 July 1972; Duncombe, Foreign economic policy, 634-38), Schmidt told him the monetary situation was "bad and getting worse". Schmidt complained that "billions of dollars are floating about the world and Germany is taking in too many of them." He warned Kissinger he would not repeat his predecessor Schiller's resort to floating to deal with massive capital inflows: he would instead introduce French-style capital controls immediately. Schmidt claimed the FRG Cabinet was united on this, having discussed its options and come down strongly in favour of controls. (This precipitated Schiller's resignation.) Noting the deutschemark was under pressure already in the wake of Britain floating sterling the previous month, Schmidt stated "This will be the number one campaign issue (in the up-coming Federal elections). If I am to survive politically, I will have to do something about this..." Schmidt drove home his point a few days later back in Bonn. He complained to US ambassador, Martin Hillenbrand, that US monetary passivity was undermining European confidence in US support for the Smithsonian Agreement and repeated his threat to introduce capital controls (Secret telegram from US Embassy in Bonn to Department of State, 1 August 1972; Duncombe, Foreign economic policy, 648-50).

⁵⁰ The yen appreciated 16.9% in nominal terms under the Smithsonian Agreement. However, this overstates the yen's loss of competitiveness because all G10 currencies except the dollar also appreciated. Solomon calculated the yen's "effective appreciation" (i.e. after allowing for other currencies' appreciations) was only 11¼%. By the same logic, the deutschemark's "effective appreciation" was only 4¾% (Solomon, International monetary system, 210). Post-Smithsonian Japan preferred to add to its foreign exchange reserves rather than adjust its macroeconomic policies. Gyohten observed Japan's official reserves increased \$7 bn in 1972 as the Bank of Japan resisted "relentless upward pressure" on its fixed exchange rate (Volcker and Gyohten, Changing fortunes, 129). Japan was also happy to remain mercantilist and fended off criticisms: see, for example, the speech made by Mr Shiro Inoue, Executive Director of the Bank of Japan, to the American Bankers Association's International Monetary Conference in Montreal on 12 May 1972. Inoue pleaded for the rest of the world to give Japan time to adjust the Japanese economy from being "an export-oriented to a domestically welfare-oriented economy" (Bank of England archive file OV53/42).

trade and monetary issues.⁵¹ As Connally found in 1971, US positive structural power was insufficient to overcome the combined negative structural power of other G10 states. Europe and Japan did not want this institution and they thwarted US efforts to create it;

- Washington continued to drag its feet on international monetary reform, resisting others' plans and not producing its own until late September.⁵²

⁵¹ During the first half of 1972 US policy makers and officials repeatedly proposed G10 states should create a new institution in which trade and international monetary policies could be discussed and co-ordinated. Volcker advocated the idea in a speech in Montreal (Speech by Paul Volcker, to the American Bankers Association's annual International Monetary Conference, Montreal, 12 May 1972; Bank of England archive file OV53/42). The proposal stemmed from Connally's failure to achieve trade policy gains in 1971 and was an attempt to achieve the same objective by a different route.

The US' institutional proposal was heard clearly in Europe. The chairman of the Swiss National Bank, Dr. Edwin Stopper, referred to the idea in his speech to his bank's annual general meeting on 28 April 1972 (text of this speech is in Bank of England archive file OV53/42). Chancellor Barber made his opposition to the idea clear in his secret letter to Lord Cromer of 11 April (Bank of England archive file OV53/42) in the expectation Cromer would discretely feed the British view into US officials' thinking. The FCO warned its posts abroad of the US proposal to link monetary and trade matters institutionally in case they were lobbied to support the idea (Restricted FCO guidance telegram 148, *The International Monetary Situation*, issued to all posts on 7 June 1972; Bank of England archive file OV53/43). The US got no encouragement from Europe to develop the proposal and, in a relatively minor example of the limits to US positive structural power, the proposal was dropped when Shultz replaced Connally.

It is perhaps unsurprising this failed US initiative is ignored by academics championing "structural power" explanations of events because the US was unable to get its way on the matter. It is more surprising, however, that academics leaning towards the hegemonic decline theories ignored this US defeat, which was consistent with a declinist hypothesis.

⁵² Connally was in no rush to push through reforms, or even identify the forum in which the reform discussions might take place. The dollar's privileged position meant the US could afford to take its time: Connally preferred procrastination to progress on reform. He dithered over the choice of forum in which the reform discussions would take place and instructed Volcker not to begin analytical work on designing a new international monetary order (Volcker and Gyohten, *Changing fortunes*, 115).

The British soon discovered the US Treasury had resurrected its delaying tactics, denying it had views on reform's substance. A senior Bank of England official, J. A. Marshall, visited Washington, where he met his counterparts from the Federal Reserve, Treasury, State Department, CEA and the Council for International Economic Policy in March 1972, before calling on officials in Ottawa. Marshall's back-to-office report (confidential Report of 6-13 March 1972, Visits to Washington and Ottawa, circulated 20 March 1972; Bank of England archive file OV53/42) described US officials as offering "destructive" criticism of UK proposals for "urgent" reforms, but US officials suggested "no positive improvements they were prepared, however informally, to back". In Ottawa, Marshall found the US foot-dragging worried Canadian Treasury and Bank of Canada officials. He reported them forecasting the US would "go slow" on reform and continue to run deficits, causing the world to divide into discrete currency blocs. Marshall reported Canadian officials were averse to Canada joining a dollar block; they therefore wanted the US to accelerate the reform process.

The US foot-dragging continued nonetheless. Volcker made a speech to the American Bankers Association's International Monetary Conference in Montreal in May in which he declared "... we in the US have no pre-packaged plan for reform" (Speech by Paul Volcker, to the American Bankers Association's annual International Monetary Conference, Montreal, 12 May 1972; Bank of England archive file OV53/42). He did not add that the US had been in no hurry to develop one either! Echoing Connally's thinking during autumn 1971, Volcker reminded his audience: "The real challenge for US economic leadership is this: we need to make our case clearly and forcibly for new policies that will adequately reflect the balance of power." Volcker meant by this the rest of the world should recognise - and accommodate - the US requirement

Table 6.2 US Economy: macroeconomic indicators, 1970-73⁵³				
	1970	1971	1972	1973
Policy variables				
Fiscal balance (\$bn)	-11.4	-24.8	-17.4	-8.0
Money supply growth (%)				
M1	5.7	7.0	9.4	6.1
M3	7.1	13.0	12.7	6.8
Outcomes				
Real GNP (% growth)	-0.2	3.4	5.7	5.8
Inflation (%)	5.4	5.0	4.2	5.7
Unemployment rate (%)	4.8	5.8	5.5	4.8
Current account (\$bn)	2.3	-1.4	-5.8	7.1
o/w trade balance (\$bn)	2.6	-2.3	-6.4	0.9

The 1973 Dollar Crisis: a Second Devaluation

The Smithsonian Agreement realigned exchange rates, but did nothing to promote prompt adjustment between economies over time. G10 economies were on divergent paths: the US had been pursuing a boom fuelled by excessive monetary expansion in 1972 so it was only a matter of time before dollar exchange rates would have to be adjusted. Two events sparked the inevitable crisis: Switzerland floated its franc in January 1973 to deter capital escaping an Italian political crisis; and Nixon eased his wage and price controls on 11 January 1973, relaxing its fight against inflation and creating the

for a current account surplus large enough to guarantee dollar exchange rate stability while also funding the US' projection of its power through its overseas spending on its military, foreign aid and foreign direct investment outflows.

When Shultz replaced Connally in May 1972 he knew Nixon wanted a unified Western alliance to impress Moscow and reassure the US electorate; foreign economic policy had returned to being a secondary issue for Nixon. Shultz promoted Western unity by: ending the Connally-style confrontations with the G10 and adopting a conciliatory approach instead; intervening (briefly) in the foreign exchange market to show the US was prepared to defend Smithsonian exchange rates; dealing with G10 demands to initiate international monetary reform discussions by proposing a reform plan at the IMF Annual Meeting in September 1972; and removing the final barrier to progress on reforms by accepting discussions could be held in a new "Committee of 20" (C20) forum based on IMF constituencies.

⁵³ Sources: IMF *International Financial Statistics Yearbook 1999*, except: real GNP (Stein, *Presidential economics*, 379-88); inflation (OECD *Economic Outlook*, 36 December 1984); and current account and trade balances, (US Department of Commerce's Bureau of Economic Analysis, *International Transactions, 1960-present* [www.bea.gov/international/]).

impression of “indifference” towards exchange rate stability.⁵⁴ Markets dumped dollars; the deutschemark was seen as a safer haven. Eurodollar market speculation magnified dollar capital flows to the FRG: the Bundesbank absorbed \$4.9 bn in the week of 5-9 February, including \$1.1 bn in one day.⁵⁵

The demonstration of market power prompted states to deploy their own power. Schmidt imposed new FRG capital controls to block capital inflows. Shultz immediately undermined him in a very public and unsophisticated example of the US’ ability to exert relational (bilateral) power over its allies and influence markets.⁵⁶ He told Schmidt publicly he should float the deutschemark.⁵⁷ Chancellor Brandt, fearing the impact of currency speculation on EEC monetary union, wrote to Nixon on 9 February, warning him a failure to stabilise markets would have “dangerous political consequences” for alliance cohesion; Brandt pleaded for Nixon to authorise intervention by the Federal Reserve: “I would appreciate it if the American monetary authorities would, in the future, do everything in their power to support the (DM/\$) exchange rate.”⁵⁸

Other EEC states also received large dollar inflows, although not on the scale facing the FRG. The unevenness of the massive dollar-denominated capital inflows made it impossible for European central banks to maintain the EEC’s currency snake within its 4½% tunnel. European central banks were unable to react quickly enough to disrupt the speculation and most lacked the fire-power to take on the speculators. International markets had passed beyond national central banks’ control. If any state were able hold the line against markets, it should have been the FRG with its new capital controls. Schmidt

⁵⁴ Volcker outlines market suspicions of US “indifference” to exchange rates in Volcker and Gyohten, *Changing fortunes*, 106. On 11 January 1973 Shultz announced the abolition of the Pay and Prices Boards as part of the Phase 3 renewal of the wages and prices measures. In the absence of the Boards, there was no institution responsible for enforcing pay and price restraint and the policy lost credibility. Market expectations of a rise in inflation were confirmed in the consumer price data for the first quarter of 1973, which recorded inflation soaring to 8.7%. Italy introduced a two-tier exchange rate system on 23 January in an unsuccessful effort to strengthen its capital controls and prevent capital flight.

⁵⁵ Solomon, *International monetary system*, 230

⁵⁶ “Compulsory power” in Barnett and Duvall’s terminology; see chart 1.1, chapter 1

⁵⁷ The *New York Sunday Times* reported Shultz advising the FRG to float the deutschemark (Coombs, *Arena of international finance*, 228); the *New York Times* reported him “sympathetic” to deutschemark appreciation on 6 February (Solomon, *International monetary system*, 230). This coincided with a secret agreement by Nixon, Shultz and Burns to depreciate the dollar against G10 currencies (transcript of White House tape recording a not classified conversation among President Nixon, Treasury Secretary Shultz and chairman of the Federal Reserve Board Burns, held on 6 February 1973; Rasmussen, *Foreign economic policy*, 4-21).

⁵⁸ Letter from FRG Chancellor Brandt to President Nixon, not classified, 9 February 1973; Rasmussen, *Foreign economic policy*, 39-40

expected his controls to dampen market pressures and defend the Smithsonian exchange rate; his confidence was misplaced. The Bundesbank buckled and closed its foreign exchange market on 10 February; other European central banks soon followed, closing their foreign exchange markets on 12 February. The Bank of Japan had already closed its market on 10 February.⁵⁹

Nixon responded to Brandt's letter on 10 February, agreeing there was a need for Western governments to co-operate.⁶⁰ He had already despatched Volcker to Tokyo and Europe on what turned out to be a 31,000 mile exercise in financial diplomacy aimed at devaluing and depreciating the dollar.

The White House tapes show Nixon met Shultz and Burns on 6 February to discuss the international monetary situation.⁶¹ Burns warned Nixon some \$4.3 bn had flowed out of the US, much of it to the FRG, in the previous two weeks. He argued the situation "needs correction". Shultz agreed and proposed a five point package to Nixon:

- Realign exchange rates by devaluing the dollar 6½%, revaluing the yen against gold by the same amount (i.e. appreciate the yen 13% against the dollar's new value) and ensuring all other currencies retained their present values against gold (i.e. appreciate 6½% against the devalued dollar). These changes, if agreed, would complete the 15% dollar depreciation Connally had sought before being obliged to accept a smaller depreciation at the Smithsonian;
- if the rest of the G10 did not accept this, "announce what we think the proper exchange rates are, and they (the other G10 states) will be forced to struggle in their currency markets and we won't help them any";
- obtain new trade legislation from Congress giving the President new powers to negotiate multilateral trade liberalisation to win the US "a fair deal in world trade" (the start of the GATT Tokyo Round was in the offing) and, more controversially, to impose a surcharge in response to any US balance of payments emergency to safeguard US producers;

⁵⁹ The Bank of Japan had purchased \$1.1 bn in nine days.

⁶⁰ Silber, Volcker, 114

⁶¹ The White house tapes record a conversation (not classified) among President Nixon, Treasury Secretary Shultz and chairman of the Federal Reserve Board Burns, held on 6 February 1973; Rasmussen, Foreign economic policy, 4-21

- sell some of the G10 central banks' monetary gold to the private sector;⁶² and,
- abolish the remaining US capital controls over the next 1-2 years.

Shultz suggested the alternative to his package was for the US to insist on introducing a floating exchange rate regime. Some scholars, including Strange and Gowan, claimed a floating exchange rate regime was the US' true goal once Nixon suspended convertibility in 1971. Archived materials show this was not the case. Nixon rejected floating unequivocally in the 6 February meeting, saying: "I think it's just too much of a 'To hell with the rest of the world' as a policy". Burns agreed, warning that floating "would be regarded as economic belligerency on our part against everybody else." The Foreign Economic Policy Executive continued to oppose creating an international monetary order based on floating exchange rates.⁶³

Nixon approved Shultz's five-point package on condition other states agreed to the gold sales and ending US capital controls. Nixon sent Volcker to Japan and Europe immediately to secure their agreement to the proposed exchange rate realignment within "three days or so". Nixon sent a message to Japanese Prime Minister Tanaka on 7 February declaring the foreign exchange market crisis indicated it was time for the US and Japan to co-operate and realign their exchange rates; he warned Tanaka of Volcker's impending visit to Tokyo to discuss this.⁶⁴ Volcker was on his way before Nixon's cabled letter was received in Tokyo!

Volcker's mission was supposedly secret to prevent press speculation triggering more currency speculation. On his arrival in Tokyo on Thursday 8 February he was taken immediately to Japanese Finance Minister Aichi's home. Volcker used Shultz's five point plan as a template, but substituted some ideas of his own. Instead of bargaining for 6½% dollar devaluation alongside a 6½% revaluation of the yen, Volcker reverted to a plan he had put to Shultz before

⁶² Burns described this measure as "silly" from an economic perspective, but it would signal the US' determination to reduce gold's role in the international monetary system and be popular with Republican Congressmen because it represented a new freedom for US residents to hold gold.

⁶³ Volcker was not present at this meeting, but was a consistent advocate of fixed exchange rates. Kissinger, the other absent member of the Foreign Economic Policy Executive, had no views as to whether fixed or floating exchange rates were preferable.

⁶⁴ Undated confidential letter from President Nixon to Japanese Prime Minister Tanaka, sent on 7 February 1973; Rasmussen, Foreign economic policy, 22

Nixon met Shultz and Burns on 6 February.⁶⁵ This envisaged the US devaluing the dollar by 10% against gold and Japan matching it with a 10% revaluation (i.e. a 20% gain in US competitiveness), while all other G10 states were to hold their currencies constant against gold (which would deliver a 10% dollar depreciation against these currencies). Whether Volcker did this because he felt he knew better than his superiors, or because he believed Aichi would negotiate down his 10% demand to 6½% is unclear.

Volcker made progress, but failed to get all he wanted. The discussion with Aichi, often heated, lasted two hours.⁶⁶ Volcker's unrestrained threats were extreme, even by Connally standards. Volcker threatened to apply a new surcharge on imports from Japan, end US capital controls unilaterally (leading to more dollar outflows to Japan) and reveal to the media his supposedly secret presence in Tokyo and the US' preferred dollar/yen exchange rate, provoking speculative capital flows to Japan. Nixon's letter to Tanaka had promised "co-operation", but Volcker arrived in Tokyo practicing domination.

Aichi defended Japanese commercial interests robustly, but was forced to concede a yen appreciation when Volcker said he would implement his threats immediately. Aichi refused to set a new exchange rate, but promised to allow the yen to float upwards by 15% against the devalued dollar. Gyohten described Volcker as departing "half satisfied, half disappointed", but Aichi's concession met Volcker's needs. He resumed his travels, flying to Bonn.⁶⁷

Volcker arrived late, missing his meeting with Schmidt and Emminger on the evening of Friday 9 February. Meanwhile Schmidt, rather than kicking his heels waiting for Volcker, had gone to Paris to co-ordinate a European position with Giscard d'Estaing. Schmidt was anything but hospitable when he, Emminger and Volcker met the following morning: he was angry about the US' inability to prevent the flight from the dollar and its disruptive effects on EEC monetary union.⁶⁸ Volcker's memoir records, perhaps diplomatically, how

⁶⁵ Volcker and Gyohten, *Changing fortunes*, 106. Volcker claimed his "ten-to-ten" plan had Bundesbank backing: "My own views were reinforced when I received a confidential personal message from Otmar Emminger at the Bundesbank, suggesting essentially the same course of action."

⁶⁶ Secret Memorandum of Conversation, Tokyo, 4 April 1973; Rasmussen, *Foreign economic policy*, 23-38

⁶⁷ Gyohten in Volcker and Gyohten, *Changing fortunes*, 130

⁶⁸ In an interview with *The Economist* in September 1979 Schmidt said "I see (monetary union) as an instrument to let the countries of the EEC grow together more quickly than hitherto.

Schmidt responded “rather cautiously” to the US proposal, “clearly not rejecting the idea but wanting to consult further with his European colleagues”.⁶⁹

Schmidt’s response, in fact, took Volcker aback by its hostility. Schmidt harangued Volcker: “The United States does not understand how much damage the last ten days have done to European-American relations...It seems as though the United States welcomed the monetary crisis...You believe this is a good development.” Schmidt added “The problem is a dollar problem...And do not make the mistake of underestimating the political repercussions.”⁷⁰ When Volcker protested he had come to Bonn to help resolve the crisis Schmidt responded abruptly: “Okay, let’s do it this weekend.”⁷¹ Schmidt, like Volcker, needed an early solution: his capital controls had failed spectacularly and, in a political as well as economic defeat, he had been obliged belatedly to close the FRG’s foreign exchange market; all could see his political rival, Schiller, would have acted faster and more effectively.

Volcker travelled to London later that day, receiving a sympathetic hearing from Chancellor Barber. He flew Paris the following day, Sunday 11 February. Giscard listened to Volcker’s proposal in the morning. He suggested they reconvene that evening and include Schmidt and Barber. Volcker agreed, flew to Rome where he met the Italian Treasury Minister, Giovanni Malagodi, and persuaded him, a likely ally, to fly to Paris in Volcker’s aircraft and gate-crash that evening’s Finance Ministers’ meeting. When the Finance Ministers met, Volcker was unable to persuade Giscard to accept the US proposal on gold, but otherwise got what he wanted.⁷² The Europeans agreed to the US ending their remaining capital controls in the near future and agreed to a “standstill” in the gold price of their currencies as the yen was floated upwards and the dollar devalued against gold.⁷³ The possibility of a joint float of EEC currencies against the dollar was discussed, but not pursued.⁷⁴

I see it as an instrument to strengthen the EEC institutionally, and I see it as an incentive for the Americans to understand that they should not let the dollar go down the drain” (Schmidt and Hanreider, *Perspectives on politics*, 211).

⁶⁹ Volcker and Gyohten, *Changing fortunes*, 110

⁷⁰ Quoted in Silber, Volcker, 116; Silber accessed the meeting’s US note-taker’s record.

⁷¹ Ibid.

⁷² In a sign of Franco-US arguments to come, Giscard ruled out gold playing a smaller role in any future international monetary order than it had under the Bretton Woods regime

⁷³ The controls were lifted in early 1974.

⁷⁴ Volcker believed Giscard and Schmidt did not pursue the joint float idea because it would have been beyond their central banks’ technical capabilities and there was insufficient

Finance Ministers used the following day to obtain their governments' agreement to the deal. Volcker flew to Bonn to meet the Japanese Vice Minister of Finance for International Affairs, Takashi Hosomi, recently arrived from Tokyo. Hosomi found no European support for Japanese opposition to US pressure and accepted the inevitable.⁷⁵ He and Volcker finalised the wording of the agreement concerning the yen's float: Japan would agree to float the yen cleanly up to a rate of ¥264 to the dollar (a 17% appreciation), and up to ¥257 (20% appreciation) if market circumstances warranted it.⁷⁶ Volcker cleared these understandings with Shultz late on Monday 12 February (European time). Shultz announced Volcker's success that evening in Washington: the administration would ask Congress to approve a 10% dollar devaluation against gold (to \$42.22) and new trade legislation (covering fast track and safeguard measures); the Japanese government would float the yen; and the remaining US capital controls would be lifted in the near future.

It had taken Volcker only five days in 1973 to achieve a larger exchange rate realignment than Connally had achieved in five months in 1971. His robust financial diplomacy demonstrated the US' ability to harness capital market pressures to strengthen its leadership and exert its "relational", bilateral power over allies on the US' priority issues.⁷⁷ Or was this evidence of US positive structural power? If other states respected the terms of Volcker's February currency realignment, they would change their behaviours (i.e. operate on the basis of appreciated exchange rates), thereby changing the international monetary system itself. Once states' behaviours and the international monetary system began to change, as Volcker was confident would happen, there would be no significant obstacle to the US achieving C20 agreement on reforming the

political cohesion within the EEC to make such a system work (Volcker and Gyohten, *Changing fortunes*, 110). His assessment was probably correct: after all, Schiller had previously aired the "joint float" idea several times unsuccessfully in EEC Finance Ministers' meetings.

⁷⁵ Gyohten observed sadly that in Bonn "To our great dismay, we found ourselves totally isolated again. Volcker had skilfully organised the Europeans into a gang against us." Schmidt threatened the EEC would start a trade war against Japan if Hosomi refused the US' terms (Volcker and Gyohten, *Changing fortunes*, 130).

⁷⁶ The Japanese bargained hard. The Japanese government did not confirm its agreement to the ¥257 "ceiling" on the yen's movement until 3:30 am (Bonn time) on Tuesday 13 February 1973 in a telephone conversation between Volcker and Koichi Inamura, Vice Minister for International Monetary Affairs in the Ministry of Finance. See Volcker's secret Note of Oral Understanding, 15 February 1973; Rasmussen; *Foreign economic policy*, 48.

⁷⁷ D'Arista described the February 1973 currency realignment as a "unilateral" US action, despite the effort Volcker had put into obtaining a multilateral agreement (see D'Arista, "Evolving international monetary system", 644).

rules for the international monetary order. Such reforms would embody and institutionalise the new behaviours the US wanted from other states. With changes to states' behaviours as well as changes to both the international monetary system and order in prospect, the breakthrough to a new, reformed international monetary regime appeared to be on the horizon - and at little cost to the US. Volcker's only concession had been on the minor issue of central bank gold sales to the private sector, a symbolic measure. And the US' prize would include not only a new international monetary order respecting Washington's preferences, but also the prospect of stronger US current account balances in the future, enabling the US to fund the foreign currency costs of its overseas military and foreign aid spending and its direct investment abroad. Nixon and Kissinger had wanted US economic power to recover: Volcker appeared to have delivered it.

Volcker had taken advantage of favourable circumstances: financial markets had effectively vetoed the Smithsonian exchange rates agreed 14 months earlier; and central banks in Europe and Japan had been reduced to closing their foreign exchange markets to contain market pressures - a temporary measure intended to buy time, not a sustainable policy. The UK, Italy and Switzerland had no interest in making difficulties for the US: their currencies were floating already. France was approaching national elections and Pompidou had no desire to see his formidable reputation in the economic sphere damaged by a crisis in Europe's foreign exchange markets.⁷⁸ So France, like the FRG, prioritised protection of the EEC's monetary union and swallowed Volcker's medicine. European "snake" currencies would lose some competitiveness against the dollar, but the snake would be compensated by competitiveness gains against the floating yen.

Volcker appeared to have strengthened US hegemony by ensuring US power prevailed in an economic crisis. Favourable US media coverage of Volcker's efforts and a "sizeable" repatriation of US dollars held abroad encouraged the US Treasury to believe it was at last gaining the upper hand on international monetary issues.⁷⁹ Ultimate success on monetary reform

⁷⁸ French elections were scheduled for 4 and 11 March 1973.

⁷⁹ Volcker claimed: "The agreement met with effusive acclaim from commentators on international financial affairs, from those concerned with the political relationships among

appeared to be in prospect. After his 31,000 mile journey into international financial diplomacy, Volcker returned to Washington in triumph.⁸⁰ The only fly in the ointment was that, with foreign exchange markets closed, no one had asked foreign exchange dealers what they thought of his currency realignment. When the answer came, it was brutal.

The Move to Generalised Floating: Politics Triumphs

Adoption of generalised floating in March 1973 may be one of the most misunderstood developments in international political economy. Many scholars discussing this event scored it as an economic policy success for the US. One can understand why scholars subscribing to “structural power” explanations of events (Table 6.1) would interpret the introduction of generalised floating as a US success. The event changed the international monetary order and system as well as states’ and financial institutions’ behaviours. The economic basis of the international monetary order shifted fundamentally from fixed to floating exchange rates, and from capital controls to free capital mobility. This new international monetary order was later enhanced by introducing innovative regulatory structures.⁸¹ The US progressively exploited its comparative advantage in finance and promoted financial liberalisation as forcefully as it promoted globalisation of trade in goods and non-financial services. Wall Street enriched itself - and expanded the US tax base - by creating innovative financial products and instruments and creating new markets in which to trade them. The move to generalised floating proved to be one of the pillars of neoliberalism, the ideology behind globalisation and financialisation.⁸²

The consequences of the fixed exchange rate system’s collapse were so dramatic, so fundamental to future international economic developments and so beneficial for the US that Marxists such as Gowan concluded the US must have

Europe, Japan and the United States, and from virtually all editorial writers” (Volcker and Gyohten, *Changing fortunes*, 111-112).

⁸⁰ Volcker’s performance generated widespread acclaim in the US. Wells quotes Congressman Reuss, the House of Representatives’ leading expert on international monetary issues, as praising Volcker for “an excellent job” (Wells, *Economist in an uncertain world*, 107).

⁸¹ These were negotiated between the US and its allies at the BIS. Slaughter, in “Governing the global economy”, discusses these, stressing their innovative character.

⁸² The origins and evolution of neoliberalism are described succinctly in Tickell and Peck, “Making global rules.”

precipitated the collapse deliberately to boost Wall Street's prosperity and US power.⁸³ Panitch and Gindin also took the view the US engineered the end of G10 fixed exchange rates: "... in early 1973 the US prevailed on the Japanese and European states to embrace a system of floating exchange rates...".⁸⁴

It is perhaps no coincidence that Gowan, Panitch and Gindin subscribed to the concept of structural power as elaborated by Strange. Many Realists also adopted this perspective, developing her concept to give Wall Street prominence as Washington's helpmate in exercising US structural power.⁸⁵ Other Realists set Strange's "structural power" concept in a broader historical context.⁸⁶ Some Liberals also explained the move to floating in terms of US structural power (Table 6.1).⁸⁷ These authors took the view the US used its structural power to re-write the international monetary order's rules to achieve relative *economic* gains for itself. It's a good story, but, as the archives reveal, it does not explain what happened.

The White House tapes and archived papers reveal Nixon, when confronted with a continued foreign exchange market crisis in March 1973, chose to exploit the crisis to make *political* gains at Europe's expense. He ruled out defending the fixed exchange rate system precisely for this reason. He (and Kissinger) wanted to lure EEC states into attempting a joint currency float against the dollar because they believed Europe would fail. The failure would wreck European monetary union, undermining European cohesion and integration. Nixon's objectives were entirely *political*: he wanted European states to support the US in forthcoming security negotiations with the USSR on Mutually Balanced Force Reduction and at the European Security Conference, as well as back US initiatives in NATO. Kissinger wanted to create discord in

⁸³ That is the storyline behind Gowan's *Global Gamble*. He argued the US "gained its dollar standard" through blocking international monetary reforms in the C20 forum: "(the Nixon administration) was using the whole (C20) exercise as a means of buying time while it imposed its own will on events outside the conference discussions" (Gowan, *Global Gamble*, 20). Although he does not refer specifically to the move to generalised floating in March 1973, Gowan's vague reference to "events" presumable includes this, as is suggested in his subsequent remark: "The whole point of the Nixon moves to destroy the Bretton Woods system and set up the Dollar-Wall Street Regime *was to put America first*" (Ibid., 31).

⁸⁴ Panitch and Gindin, *Making of global capitalism*, 145

⁸⁵ See, for example, Seabrooke, *US power in international finance*.

⁸⁶ See Kunz, *Butter and guns*, and Mastanduno, "System maker and privilege taker"

⁸⁷ For examples of Liberals adopting a structural power explanation of these events, see Bergsten, *Dilemmas of the dollar*, Eichengreen, *Globalising capital* and *Exorbitant privilege*, and Moffitt, *World's money*. The majority of Liberals, however, cleaved to hegemonic decline or purely economic explanations of the move to generalised floating, as is clear from table 6.1.

Europe and divide Europeans to help him obtain a US-dominated, modernised transatlantic alliance in his Year of Europe negotiations. Nixon and Kissinger feared a successfully integrating Europe might have the confidence to refuse to toe the US line and might instead support France's approach to East-West relations, or even the FRG's *Ostpolitik*. When Nixon informed the Foreign Economic Policy Executive on 3 March 1973 "I don't want to be in a position of making a decision on this which is good economically", he explicitly prioritised political over economic objectives.⁸⁸ What prompted Nixon to side-line his Treasury's international monetary diplomacy so soon after Volcker's hegemony-strengthening currency realignment triumph?

Markets were worried about the US economy: Nixon's pre-election boom continued into 1973, stoking inflationary pressures; relaxing price and wage controls in January threatened to allow pent-up inflation to get out of hand; and the monthly trade deficit was growing.⁸⁹ Markets speculated against dollars once it became clear the Federal Reserve's Open Market Committee would not raise interest rates to curb excessive US spending.⁹⁰ Interest rate differentials favoured moving funds to Europe (Table 6.3).⁹¹ Volcker's realigned exchange rates were under pressure immediately because the deutschemark and gold offered the best returns and safest havens. Billions of dollars headed for Frankfurt and the market price of gold jumped to \$89 per ounce, double the new official price to be used by central banks.⁹² The Bundesbank broke its own record for dollar inflows and closed its foreign exchange market again on 2 March.⁹³ Most European central banks followed the FRG's lead.

⁸⁸ Rasmussen, Foreign economic policy, 69

⁸⁹ The annual trade deficit had reached \$6.4 bn in 1972. Monthly deficits were still rising in the early part of 1973 as excessive domestic spending sucked in more imports and depreciation pushed up their costs in dollars.

⁹⁰ The Federal Reserve's Open Market Committee (FOMC) - the body that determines US interest rate policy - met on 13 February, the day after Shultz had announced the dollar's second devaluation in fourteen months. Burns told the Committee this would be the last devaluation. But he and his Committee decided against raising interest rates and thereby missed an opportunity to build confidence in the newly-fixed dollar exchange rate.

⁹¹ Table 6.3 shows short-term interest rate differentials favoured investment in European assets. Interest rate differentials on long-term assets (i.e. assets with an original maturity of more than one year) also favoured investment abroad. US interest rates on long term assets were never higher than - and on average were two percentage points below - the average of those in Canada, France, the FRG, Japan, Switzerland and the UK throughout 1967-77 according to the OECD's *Economic Outlook* (No. 36).

⁹² After the dollar's devaluation in February 1973, the official price of gold rose to \$42.22 per fine ounce. See Solomon, International monetary system, 231

⁹³ The Bundesbank took in \$2.7 bn. on a single day on 1 March 1973 (Volcker and Gyohten, *Changing fortunes*, 131).

Table 6.3 US and European short-term interest rates and differentials, February-March 1973⁹⁴					
	Asset, 3 month maturity (%):			Interest rate differential (%):	
	US Treasury bill	LIBOR deposit	Frankfurt banks' deposit rate	T-bill minus LIBOR	T-bill minus Frankfurt rate
February	5.56	7.45	7.96	-1.89	-2.40
March	6.05	8.52	8.77	-2.47	-2.72

Government attitudes towards floating exchange rates were changing. Support was no longer confined to the Friedmanite outer reaches of academia, as illustrated by British officials' reactions to the foreign exchange markets' post-devaluation attack on the dollar and by their comments on the US' performance in an OECD WP3 meeting in Paris in February 1973.⁹⁵ British Treasury officials' accepted generalised floating would be in the UK's best interests; the Bank of England feared foreign exchange market power was all but irresistible, making fixed rates impossible to defend. The OECD WP3 meeting's mood was despondent only two weeks after Shultz had announced the Volcker realignment/devaluation package. HM Treasury official Derek Mitchell recorded his impressions in a minute to his superior, Geoffrey Littler:

“Discussion was overshadowed by the different degrees of gloom expressed in WP3 itself about the outlook following the realignment. Above all, the spread of floating... is clearly weakening faith in the principle of fixed but adjustable parities. On some major aspects of reform it was less clear than ever

⁹⁴ Sources: US Federal Reserve Bank for 3 month US T-bill and LIBOR deposit rates, www.federalreserve.gov/releases/H15/data.htm; Bundesbank for 3 month deposit rate paid by Frankfurt banks, www.bundesbank.de/Navigation/EN/Statistics/Time_series_databases/Macro_economic_time_series/

⁹⁵ Deputy Finance Ministers and their officials participated in this meeting.

before not only where we are going, but where we should aim to go.”⁹⁶

Jack Bennett, Volcker’s deputy and the US representative at WP3, was strongly pro-floating.⁹⁷ He would doubtless have been pleased had he known British Treasury Ministers were being briefed the era of fixed exchange rates was coming to an end. Geoffrey Littler, the most senior Treasury official responsible for international monetary affairs, produced a confidential brief for ministers on UK policy on international monetary reform.⁹⁸ He noted the UK had until then consistently advocated adoption of “fixed but adjustable parities” in the C20 negotiations. Littler argued, however, the UK’s position “would be by no means badly suited under a more flexible system”. This was just as well, he thought, because that was what he expected to emerge. Littler predicted reform was unlikely to be agreed before late 1974 at the earliest and “government opinion around the world will follow the trend of academic opinion in favour of generalised floating”. He forecast other major currencies would make increased use of floating. This would benefit Britain, Littler argued, by “fortifying” sterling - it was floating already - and enable ministers to meet their main objectives, which included profiting from the City’s central role in the world financial system; the British government should therefore welcome the spread of floating and not create obstacles.

Kit McMahon, the Bank of England’s most senior official engaged in international monetary policy, also attended February’s WP3 meeting. It worried him. He sent a secret, highly controversial minute on the prospects for international monetary reform to the Bank’s Governor, Leslie O’Brien.⁹⁹ McMahon argued the game was up for fixed exchange rates and UK policy in the C20 negotiations was “out-dated”, having been overtaken by financial markets’ growing power. McMahon revealed Bennett had not helped the US’ cause in WP3 by being provocative and “at his sourest”. When other states

⁹⁶ HM Treasury confidential internal minute from D. J. Mitchell to R.G. Littler, 26 February; Bank of England archive file OV53/69. Canada and the UK were the only two states to have floating exchange rates at the end of 1972; by February 1973 Italy, Japan and Switzerland were also floating their currencies.

⁹⁷ Jack Bennett was Deputy Undersecretary of the Treasury for Monetary Affairs

⁹⁸ Geoffrey Littler’s confidential note on “The UK Interest in International Monetary Reform”, 23 February 1973; Bank of England archive file OV53/69.

⁹⁹ Secret minute from C. W. (Kit) McMahon to the Governors, “International Monetary Reform After the Recent Upheavals”, 28 February 1973; Bank of England archive file OV53/69.

criticised the US for announcing an early end to its capital controls, Bennett had responded by saying he disagreed with his administration; had it been up to him, US capital controls would have been abolished immediately. He denied the US was obliged to intervene to support the dollar and challenged the other representatives: "if others wished to float, the US would be content."¹⁰⁰

Bennett was a relatively senior figure, destined to replace Volcker in 1974. His WP3 intervention could be taken as evidence the Nixon administration was saying one thing in public - that it wanted a fixed exchange rate system - and another thing in private - that it was happy for other states to float their currencies. But McMahon was too shrewd an operator to be deceived. He advised the Governor "one should not take Bennett as a credible spokesman for the Administration", nor take Volcker's views "at face value".¹⁰¹ McMahon believed "the Administration is still in the process of sorting out its view in a world that is changing very fast". What worried McMahon was not US duplicity, but the power markets had developed over central banks.¹⁰² He assessed the EEC might best respond by opting for a joint currency float against the dollar: "if there are renewed signs of weakness in the dollar, a joint float looks not only (the) most likely, but the most sensible outcome".¹⁰³ The Governor took McMahon's unpalatable arguments on board and warned the City - and thus the Eurodollar market.¹⁰⁴

Senior officials in Washington, including Volcker, Burns and Coombs, understood the choice between a fixed or floating rate-based international

¹⁰⁰ Ibid.

¹⁰¹ McMahon's secret minute revealed Volcker had been encouraging the Governor to believe the US might resume intervention to defend the new, realigned fixed exchange rates.

¹⁰² McMahon believed governments had entered the C20 negotiations expecting they could control their exchange rates and need only alter their fixed rates more frequently than in the past to ensure a reformed regime would be sustainable. McMahon argued this idea was now "out-dated": central banks had lost the power to command markets and could aspire only "to hold rates a little longer"; they could not expect to sustain fixed rates when facing sustained market pressures. Markets could yet be controlled, he believed, but only through widespread capital controls. McMahon worried the C20 was not discussing this and Shultz's announcement of the end of US capital controls demonstrated the US was moving in the opposite direction. (Secret minute from C. W. McMahon to the Governors, "International Monetary Reform After the Recent Upheavals", 28 February 1973; Bank of England archive file OV53/69)

¹⁰³ Ibid,

¹⁰⁴ The Governor, Leslie O'Brien, held a confidential meeting with the chairmen of London Clearing Banks at which he told them recent exchange rate movements were "unhelpful" because they were undermining C20 work on international monetary reforms; he thought the US decision to dismantle its capital controls was also "unhelpful"; short-term capital outflows from the US were likely to result in a joint EEC float against the dollar (Governor's confidential briefing for meeting chairmen of London Clearing Banks, 28 February 1973; Bank of England archive file OV53/69).

monetary order was imminent, but had yet to be made. It seemed to them the “fixed but adjustable” exchange rate order they were intending to create through the C20 process remained attainable and viable if the US were prepared to support it actively through foreign exchange market intervention, backed by regulatory and tax measures to curb the Eurodollar market’s freedoms. Regulation, they believed, rather than the capital controls Nixon had pledged to abolish, could have sufficed. The US position on these crucial matters was defined in meetings held in the White House on 3 March 1973.

Nixon chaired the first of these meetings, a Quadriad reinforced with Volcker’s participation.¹⁰⁵ It was effectively a Foreign Economic Policy Executive meeting: only Kissinger was absent. The Quadriad members and Volcker went into the meeting expecting to discuss the foreign exchange market crisis - and international monetary issues more generally - from an economic perspective. However, they found Nixon intending to use international monetary policy for purely political purposes.

Nixon had received a letter from FRG Chancellor Brandt earlier that day.¹⁰⁶ Brandt informed Nixon he and British Prime Minister Heath had agreed EEC states would seek a solution to the foreign exchange market crisis that would strengthen European integration.¹⁰⁷ This annoyed Nixon for three reasons: the EEC was preparing to take action on the foreign exchange market crisis that would affect the dollar without first consulting the US, or its Japanese ally; Europeans would assess the merits of any solution in terms of its contribution to strengthening European integration, not its contribution to improving transatlantic relations; and Brandt appeared to prioritise EEC cohesion over the transatlantic partnership, ruling out any possibility of bilateral FRG-US measures to tackle the crisis. The lack of diplomatic courtesy and the flicker of independence exposed Nixon’s underlying feelings about Europe.

¹⁰⁵ By March 1973 the Quadriad comprised Shultz (Treasury), Burns (Federal Reserve), Ash (OMB Director) and Stein (CEA chairman) and was chaired by Nixon when he chose to do so. This meeting, chaired by Nixon and reinforced by Volcker’s participation, therefore included four of the Foreign Economic Policy Executive’s five members.

¹⁰⁶ Confidential letter from Chancellor Brandt to President Nixon, 2 March 1973; Rasmussen, Foreign economic policy, 49-50.

¹⁰⁷ Brandt’s letter revealed he and Heath had agreed “we must make every conceivable effort to find a way out which strengthens European integration.” The letter also informed Nixon “I am convinced that a joint (European) action represents at the same time an element of stabilization in the world political situation. This is to the benefit of all members of the Western world. A weakening of the Community by separate action would be harmful to all.”

Nixon believed his role was to steer the US through a global transition from US-USSR bipolarity to multipolarity involving five Great Powers: the US, USSR, China, Europe and Japan.¹⁰⁸ Publicly he claimed support for the EEC was part of the bedrock of US foreign policy in this process.¹⁰⁹ His private views were very different. He wanted to maintain close relations with Europe, but had strong doubts about Europe's ability to remain cohesive, the quality of its leaders and its foreign policy.¹¹⁰ He (and Kissinger) believed US foreign policy towards Europe had been on the wrong lines for two decades because it had backed the wrong priorities when supporting European integration, helping to create an economic giant but a military and political pygmy.¹¹¹ He believed a major shift in the global balance of power was underway that would replace bipolarity with multipolarity. This would give the US the opportunity to revise its

¹⁰⁸ Discussed in Chapter 3

¹⁰⁹ The official record of Nixon's meeting with President Pompidou in 1970, for example, shows Nixon stated "It was important for the European Common Market to develop in its own way. It will be increasingly competitive with the US as the UK comes in and it may be a rather serious problem for us in the economic sense. But (Nixon) took the long view that a strong, productive European Community including the United Kingdom is in the interests of world peace and stability. The US would have to pay some costs for achieving this bigger goal and (Nixon) did not agree with those who rejected the point." (Top Secret Memorandum of Conversation, 26 February 1970; Duncombe, Foreign economic policy, 91-92)

¹¹⁰ Nixon told a Council for International Economic Policy (CIEP) Executive Committee meeting "What is at stake here is a major shift in the world balance of power, particularly among ourselves, the Russians, the Chinese and the Japanese. As regards Europe, they will have a hell of a time acting as a bloc. They do not get on well with each other. The French don't get along with the Germans, the Germans don't get along with the British. This means we will have to work with the heads of Government in various countries and not that jackass in the European Commission in Brussels." (Secret Memorandum of Conversation, CIEP Executive Committee meeting, 11 September 1972; Duncombe, Foreign economic policy, 260-66) NB: the "jackass" in Brussels was EC President Mansholt.

Nixon had little confidence European leaders would share his global perspective: "as I judge the European politicians, except for Heath, everyone is parochial, every damned one... Brandt doesn't understand anything... he's a dullard..." (Rasmussen, Foreign economic policy, 69). Nixon may have rated Heath more highly than his EEC counterparts, but he did not rate Britain highly: "what the British do doesn't make a damned bit of difference in the world anymore. It's too bad, but it's true. What they do in Europe might, but not in the world... they aren't going to be a major factor because they are never going to have the domestic opinion to have the punch-crunch power in a military sense that will make them a major factor." (Ibid.)

Nixon told the CIEP "The Europeans recognise that they do not matter in the world anymore." He worried about Europe's "Finlandization", i.e. becoming neutral in the Cold War (Secret Memorandum of Conversation, CIEP Executive committee meeting, 11 September 1972; Duncombe, Foreign economic policy, 260-66)

¹¹¹ Kissinger summarised his and Nixon's views of US foreign policy towards Europe: "...we've worked ourselves for twenty years into a position where we have fostered European integration in an area (economics) where it's against our interests and discouraged it in the area, mainly defence, where it's in our interests... so we've made Europe depend on us in defence, which even works against our economic interest, and given them a free hand in the economic field... where it's against - so the priorities have been totally wrong." Nixon responded: "You've really got it on the head. I agree with that." (Transcript of a not classified White House tape recording a conversation among President Nixon, Treasury Secretary Shultz and the President's Assistant for National Security Affairs, Kissinger, 3 March 1973; Rasmussen, Foreign economic policy, 72-91)

relationship with Europe. Henceforth the US should not support European integration, but aim to keep European states apart so as to be able to deal with them more easily in the interests of "Atlantic unity".¹¹²

Kissinger was similarly minded about the need to both revise US foreign policy towards Europe and put Europeans in their (subordinate) place. He later summarised his philosophy for the benefit of State Department officials: "I am totally allergic to unilateral European decisions that fundamentally affect American interests taken without consultation of the United States. And my tendency is to smash any attempt in which they do it until they learn they can't do it without talking to us."¹¹³ Nixon and Kissinger seized on the February/March foreign exchange market crisis as an early opportunity to apply their new policy of disrupting European integration.

Quadriad participants were unaware of this and for two hours debated the economics of how to handle the foreign exchange market crisis. Volcker spoke first and got straight to the point: European leaders were getting desperate and were discussing the possibility of organising a common float of their currencies against the dollar.¹¹⁴ They had previously discussed but rejected the idea of a joint float, believing it to be too difficult to implement. But now Europe faced a dilemma: the US was unwilling to defend the fixed exchange rates it had agreed in February, and markets, refusing to accept these rates, were funnelling money to European states, disrupting their monetary and anti-inflation policies; if the US would not intervene, what other

¹¹² Nixon and Kissinger discussed their revised strategy on 3 March 1973. Kissinger observed: "I'm no longer so sure that European integration is all that much in our interests". Nixon replied "Oh, I'm not sure of it at all." Kissinger added: "And that therefore if we can force them to deal separately with us, whether that mightn't be better for Atlantic unity." Nixon, Kissinger and Shultz agreed the US would to pursue this policy. (Transcript of a not classified White House tape recording a conversation among President Nixon, Treasury Secretary Shultz and the President's Assistant for National Security Affairs, Kissinger, 3 March 1973; Rasmussen, Foreign economic policy, 72-91)

¹¹³ Secret Minutes of Secretary of State Kissinger's Principals and Regionals Staff Meeting, 25 April 1974 (Rasmussen, Foreign economic policy, 232-39)

¹¹⁴ "Straight to the point" may be an exaggeration. What Volcker actually said, captured on the White House tapes, was: "So you are now forced (by markets) to the point of decision. And I think there are two possible courses here in the most general terms: we can go – in fact complete the transition, which is half there, towards floating rates, at least as an interim measure. And – but the major European countries have now fixed – moving in that direction, together or separately. Or I think potentially, one could get together with these countries and decide to stabilise these rates...I think this could be done if people wanted to do it." Transcription of White House tape (not classified) of Quadriad Meeting chaired by President Nixon in the Oval Office, 3 March (Rasmussen, Foreign economic policy, 50-71). This quotation is from Volcker's remarks is on p51.

choice but floating did the Europeans have? Europeans were interpreting Washington's unwillingness to intervene in foreign exchange markets as "the US doesn't give a damn."¹¹⁵ This apparent abdication of leadership, Volcker added, was playing into French hands: Paris was building a European position against the US. If the US signalled its intention to intervene, massively and in concert with the Germans, it would relieve market pressures, undercut French leadership and the EEC would not float its currencies. The crisis required the US to decide quickly how the US should respond: show leadership by intervening and prevent a joint EEC float; or allow the Europeans to attempt a joint float which, in the unlikely event it worked, could create a competing currency bloc?

Burns and Volcker supported intervention, warning Nixon they might have to threaten "massive intervention" to discipline markets, but adding that if the threat were credible, very little would have to be spent to move markets. Shultz, anticipating hegemonic stability theory's creation in academia, argued Bretton Woods and its fixed exchange rate system had worked well "as long as we were the dominant power... I don't see how we have the muscle to so dominate the situation to make a real fixed exchange rate system of the kind we had in the post-war period..."¹¹⁶ Backed by Stein, Shultz favoured temporary floating.¹¹⁷ Shultz felt his approach was low risk for the US because a joint EEC float would probably fail: "our view is that that's difficult for them to do".¹¹⁸

The Quadriad's discussion was almost devoid of references to US domestic interests.¹¹⁹ Neoclassical realism theory predicts that when there are

¹¹⁵ Ibid., 62

¹¹⁶ Ibid., 66

¹¹⁷ Ibid., 60

¹¹⁸ Ibid., 53

¹¹⁹ The only evidence of domestic political lobbying surfaced when Shultz informed the Quadriad of a report by the chairman of the New York Federal Reserve Bank, Hayes, who wanted Nixon to know Wall Street favoured US intervention to defend fixed rates (Rasmussen, Foreign economic policy, 57). No other participant justified their comments in terms of domestic interest groups. Later that day Nixon welcomed domestic political lobbyists' lack of influence in this matter in a discussion of international monetary affairs with Kissinger and Shultz (White House tape, not classified, of an Oval Office conversation among President Nixon, the President's Assistant for National Security Affairs, Kissinger, and Treasury Secretary, Shultz, 3 March 1973; Rasmussen, Foreign economic policy, 72-91).

Gowa discusses why there is little domestic lobby interest in international monetary affairs, arguing the costs of collective action by domestic groups are high relative to the chances of their lobbying having the desired effect on decisions taken at the multilateral level on the principles on which the international monetary system is, or will be, based. Thus the game isn't worth the candle for lobby groups on issues such as the basis of the international monetary order (e.g. fixed v floating exchange rates) or the level of international reserves creation.

no overriding domestic political interests to influence the Foreign Economic Policy Executive, its members will deal with international pressures by prioritising national security interests over all else. And this is what happened.

Nixon listened patiently to his bickering economic advisers for nearly two hours before telling them they were barking up the wrong tree: he wanted the “intervention versus floating” issue judged from a purely political, not an economic, perspective. This point is always overlooked by scholars in their literature on the adoption of generalised floating. Nixon told his economic team “We are getting into Europe very heavily over the next few months...about NATO, MBFR, the European Security Conference... We are at a watershed period with regard to our relations with Europe.”¹²⁰ He wanted Europe to strengthen its military, but feared Europe was about to turn inwards, “to become isolationist”, weakening NATO in the process.¹²¹ Nixon wanted to advance his security agenda by exploiting Europe’s need for US co-operation in the international monetary area. He warned the Quadriad he did not want to make a decision “which is good economically... sometimes you have to do things economically in the world that will contribute to your political leadership. And it’s that factor ... I would like to run by Kissinger”.¹²² He sent his economic team to discuss with Kissinger how the US could best use the international monetary crisis to further US political and security interests.

Kissinger met the Quadriad briefly to consider the relative foreign policy merits of US intervention and EEC floating, but kept his powder dry for a meeting he, Shultz and Nixon held in the Oval Office to discuss the US’ response to Brandt’s letter.¹²³ Nixon and Kissinger did most of the talking. Shultz attempted to ensure economic considerations were incorporated into any decision taken about EEC floating or US currency market intervention, even

However, where policy might have an uneven impact on domestic economic actors, as in the design of capital controls for instance, lobby groups are incentivised to bring pressure to bear on policymakers and are keen to do so (See Gowa, “Public goods and political institutions”).

¹²⁰ Rasmussen, Foreign economic policy, 68

¹²¹ Ibid., 69

¹²² Ibid.

¹²³ Brandt recalled Nixon’s “embittered” reply to his letter: “The United States, which favoured European union in principle, found it difficult to accept joint European attitudes when they differed from the Americans’ own stance... Edward Heath and I managed to prevent ourselves being played off against Paris, and we promptly received embittered letters from the White House...” Brandt revealed Heath had been in Bonn on 1-2 March 1973 to discuss British participation in European monetary union, but they found themselves in the middle of a foreign exchange market crisis (Brandt, *My life*, 426).

citing a recent conversation he had had with Milton Friedman at one point, but was unsuccessful.¹²⁴ Nixon and Kissinger had the bit between their teeth: they wanted to take a political decision on international monetary policy that would help strengthen US security hegemony by disrupting European integration.

In the Quadriad meeting Burns had advised Nixon “crises have a function”, not suspecting Nixon wanted to use the foreign exchange market crisis to help bind Europe more closely into the US’ security and political agenda.¹²⁵ Nixon was uncertain as to which option would best achieve this, asking Kissinger “Would you rather (accept an EEC decision to float or) have the United States take a position of ‘leadership’, of massively intervening to protect exchange rates and so forth?”¹²⁶ Kissinger responded that he took no position on the technical and economic merits of a common EEC float or US intervention, but argued a passive US response to an EEC decision to float would devalue the dollar and “it doesn’t make us look strong either domestically or internationally”.¹²⁷ Nixon agreed with the implications of Kissinger’s point: “Moving to defend (the dollar) against speculators appeals to me”.¹²⁸

Kissinger warmed to his theme. Despite it being his and Nixon’s intention to declare 1973 “The Year of Europe”.¹²⁹ Kissinger warned Nixon: “I’m no longer sure that European integration is all that much in our interests... if we can force them to deal separately with us, whether that mightn’t be better for Atlantic unity. (So) that might mean to intervene. If you intervene, as I understand it, you must do it with the Germans. The Germans would be breaking ranks... with the others... if the intervention works... it will delay, at least for a bit, (and) make it harder to get a European monetary system.... Doing nothing not only forces the Europeans together, but enables them to

¹²⁴ Rasmussen, Foreign economic policy 76

¹²⁵ Transcription of White House tape (not classified) of Quadriad Meeting chaired by President Nixon in the Oval Office, 3 March (Rasmussen, Foreign economic policy, 50-71)

¹²⁶ Ibid., 76

¹²⁷ Ibid., 76

¹²⁸ Ibid., 78

¹²⁹ Nixon, ever willing to steal Kissinger’s thunder, effectively launched the “Year of Europe” informally. He told a news conference on 31 January 1973 “We have been paying attention to the problems of Europe, but now those problems will be put on the front burner” (Dallek, Nixon and Kissinger, 466). Kissinger formally launched the “Year of Europe” initiative in a speech in New York on 23 April 1973 in which he said the US wanted to give new political impetus to the Western alliance in 1973 and called for “a new Atlantic Alliance”. Ironically, his speech promised: “We will continue to support European unity. Based on the principles of partnership, we will make concessions to further growth... We will never consciously injure the interests of our friends in Europe or in Asia” (Kissinger, Years of upheaval, 152-53).

develop whatever policy they want and pay us off in constitutional currency; that is 'it was integration and bye'. I do not believe we should accept because if that works here, they'll apply it across the board".¹³⁰

Nixon concurred: "What I am thinking about is the use of a more positive leadership role through possible intervention in order to serve our interests in keeping Europeans apart, keeping them from developing a united policy against us... If we go the intervention route it would seem to me we have a ... leadership role with the Europeans we do not have otherwise".¹³¹

After discussing the tactics required either to encourage a doomed joint EEC currency float or embark on disruptive US foreign exchange market interventions, Nixon, Kissinger and Shultz turned their attention to strategic matters. Shultz attempted to clarify whether the US would object to further European integration. Kissinger responded

"Not formally, I think... We have - this is nobody's fault here, but we've worked ourselves for twenty years into the position where we have fostered European integration in the (economic) areas where it's against our interests and have discouraged it in the area, mainly defence, where it is in our interests... so we have made the Europeans depend on us in defence, which works against our economic interests, and given them a free hand in the economic field, where it's against – so the priorities have been completely wrong."¹³²

Nixon supported him: "You got it on the head there. I agree with that."¹³³ The meeting broke up with an agreement to disrupt European integration by intervening selectively and unevenly in foreign exchange markets to make it impossible for European central banks to hold their exchange rates within the EEC monetary union's narrow tunnel, wrecking monetary union.

Nixon and Kissinger soon had second thoughts and reversed their original decision on intervention within days when it occurred to them a massive US foreign exchange market intervention would be obvious: Europeans would

¹³⁰ Rasmussen, Foreign economic policy, 79-80

¹³¹ Ibid., 83-84.

¹³² Ibid., 90-91

¹³³ Ibid., 91

know who to blame for monetary union's collapse. European anger would focus on Washington, making it harder to manage the transatlantic relationship. If Shultz and Volcker were correct, however, the Europeans would be unable to sustain a joint float because of internal policy divisions or technical problems. Why not lure the EEC into a joint float and let markets wreck monetary union, leaving Washington with seemingly clean hands?

We know of this change in US tactics because Giscard d'Estaing invited Shultz to participate in an extraordinary G10 meeting in Paris to discuss the currency crisis on 9 March. Shultz called Kissinger on 5 March to confirm what he should say about US intervention and a joint EEC float.¹³⁴ Kissinger told him, contrary to what had been agreed on 3 March with Nixon, the US should support a joint float and should hold back any intervention until the EEC had jointly floated its snake currencies. (Intervention would then be used to drive a wedge between the deutschemark and the French franc.) This approach was confirmed when Nixon and Kissinger met Shultz on the eve of his departure to Paris (7 March) and told him to appear "constructive" in the G10 meeting, especially with Schmidt, and be more forthcoming on intervention than he was ordinarily inclined to be.¹³⁵

In later remarks to Treasury Deputy Secretary William Simon, Kissinger revealed he had only realised after the 3 March meeting with Nixon and Shultz the US would carry the blame for disrupting European integration through massive foreign exchange market intervention. Intervention would be impossible to disguise; EEC states would blame the US, reducing the chances of Europe co-operating with the US on security matters on US terms. Tactically it would be better for the US to appear to have clean hands, allowing Europeans to go ahead with their joint, but probably doomed, float and delay foreign exchange market intervention until a European state requested it from Washington. If invited to intervene, the US could then deflect any blame for currency disruption or joint float destruction onto the requesting state. Clearly, Kissinger's objectives had not changed, merely his tactics, as he told William Simon, "I basically have only one view right now which is to do as much as we

¹³⁴ Transcript of telephone call between Shultz and Kissinger, 5 March 1973; Rasmussen, Foreign economic policy, 99-101

¹³⁵ Transcript of White House tape (not classified) of Oval Office Conversation among President Nixon, the President's Assistant for National Security Affairs, Kissinger, and Treasury Secretary, Shultz, 7 March 1973; Rasmussen, Foreign economic policy, 104-12.

can to prevent a united European position without showing our hand.”¹³⁶ None of this appeared in Kissinger’s memoirs: it would have contradicted his and Washington’s protestations of good faith in the “Year of Europe” initiative.

Nixon too remained determined to oppose further European integration and to prioritise political over economic objectives. After reflecting further on his strategy towards the EEC during a day spent at Camp David on 10 March, Nixon drafted a memorandum to Kissinger setting out his thoughts.¹³⁷ He affirmed his opposition to EEC integration, arguing European states were moving in a socialist, and therefore dangerous, direction:

“European unity will not be in our interest, certainly not from a political viewpoint or from an economic viewpoint ... whether it's in the economic field, the political field, or eventually even the military field, we will find that Europe will be in increasing confrontation with the United States rather than joining with us to present a united front against Soviet encroachment... Under these circumstances, political considerations must completely override economic considerations in monetary and trade talks. This is going to be a bitter pill for Shultz to swallow but he must swallow it.”¹³⁸

Nixon proposed the US should challenge the emerging European currency “bloc” by building a rival “bloc” of its own, as Connally had once proposed. He therefore advocated “...the Connally view with regard to building our own bloc which would be made up of the United States, Japan and the under-developed countries of Latin America, Asia and Africa to the extent that we can mobilize them, must now become our objective.”¹³⁹

This approach was a marked change from the US’ post-war strategy of knitting together security and economic alliances with Europe and Japan, but it fit Nixon’s world-view. He believed bipolarity was coming to an end as the US’ military power declined relative the USSR’s (and eventually China’s) and as the US’ economic power declined relative to Japan’s and Europe’s. Nixon saw his task as managing the transition to a complex, multipolar world while maintaining

¹³⁶ Comment made by Kissinger during a telephone call to Treasury Deputy Secretary William Simon on 14 March 1973; Rasmussen, Foreign economic policy, 123.

¹³⁷ Not classified, draft Memorandum from the President to the Assistant for National Security Affairs, Kissinger, 10 March 1973; Rasmussen, Foreign economic policy, 118-19

¹³⁸ Ibid., 119

¹³⁹ Ibid.

US leadership as long as possible. He expected three states to predominate in the security sphere - the US, USSR and China - and three to predominate in the economic sphere - the US, Europe and Japan. He wanted the US to be at the centre of both spheres. Washington's challenge would be to protect its security interests by balancing against the USSR and China, while at the same time defending its economic interests against competition from Europe and Japan. Building a "dollar bloc", as outlined in his Camp David memorandum of 10 March 1973 would be one element in his preparations for the move to multipolarity, complementing his 1972 diplomatic efforts to reduce security tensions with China and the USSR.

Nixon did not get very far with this, of course, or much else after March 1973. Watergate "blew out the windows".¹⁴⁰ Haldeman's diaries reveal Watergate increasingly distracted Nixon after Haldeman's first briefing on the subject on 20 June 1972.¹⁴¹ Judge Sirica delivered his provisional prison sentences on the first four men to be found guilty of involvement in the Watergate burglary on 23 March 1973. Nixon admitted to Haldeman it would be impossible for him to govern if the pressures on him increased, and they did.¹⁴² Consumed by Watergate, Nixon had no opportunity to implement his grand strategy for creating a new role for the US in a multipolar world. He resigned on 9 August 1974, power having already leached from the ailing White House to Cabinet members and the Federal bureaucracies under their supervision.¹⁴³

All that was in the future. Meanwhile, Kissinger had a dramatic and little-known part to play in international monetary diplomacy. He had aimed to foster a personal relationship with FRG Finance Minister Schmidt. When the two men met in Washington in July 1972, Kissinger invited Schmidt to call him if

¹⁴⁰ Connally and Herkowitz, *In history's shadow*, 241

¹⁴¹ Haldeman, *Diaries*, 473. Subsequent entries show Watergate progressively absorbing increasing amounts of Nixon's time, for example entries for 11 September 1972 "President ... mainly concerned about Watergate" (*Ibid.*, 502), and 13 September 1972 "P(resident) had Mitchell, MacGregor and Connally up for dinner and a general political planning session. Spent quite a bit of time on Watergate" (*Ibid.*, 503). And so it continued with growing intensity until Nixon spent 6 hours with Haldeman on Sunday 25 March 1973 discussing Watergate to the exclusion of all else (Reeves, *Alone in the White House*, 579).

¹⁴² *Ibid.* White House governance disintegrated as those guilty of Watergate-related offences were investigated and sentenced to prison. Two of Nixon's three remaining principle aides, Haldeman and Ehrlichman, resigned at the end of April 1973, leaving only Kissinger in place. Nixon placed himself in "internal exile", spending a mere 22 working days in Washington during the following six months (*Ibid.*, 604). Kissinger observed a "lassitude" developed in Nixon and found it increasingly difficult to focus Nixon on foreign policy (Kissinger, *Years of upheaval*, 78).

¹⁴³ Kissinger, *Years of upheaval*, 76 and 80

international monetary problems threatened to spill into the political sphere. Schmidt duly called on 5 March 1973 to warn Kissinger of the political problems the dollar's crisis was creating in Europe.¹⁴⁴ Schmidt revealed Brandt wanted to initiate a joint EEC float to enable EEC currencies to ride out the foreign exchange market crisis. Schmidt assessed the odds against a successful joint float were formidable.¹⁴⁵ Nonetheless, warned Schmidt, Brandt would persevere and wanted US assistance. Kissinger asked "If you cannot organise a common float, you then want us to intervene?" Schmidt responded, in words that must have been music to Kissinger's ears, "I think in any case you should intervene if we did organise it." The FRG was walking into Kissinger's trap without the US having to set it! Kissinger encouraged the FRG to proceed.

Schmidt, having seen unhelpful media reporting from Washington and having had a fruitless telephone conversation with Shultz, called Kissinger again on 7 March.¹⁴⁶ He asked Kissinger outright "Would the US be happy with a common float?" This was what Kissinger wanted, although he was concerned by reports that France would not agree to the joint float unless it was accompanied by discriminatory trade restrictions against the US. Kissinger responded "...we can live with a common float if you do not attach too many conditions to it. If you attach a lot of discriminatory conditions to it, this become complex again... we would not oppose a common European float if it were not discriminatory in some of its conditions."¹⁴⁷ That gave Schmidt the encouragement he needed. And Kissinger could sit back and wait for the attempted joint float to blow up in the EEC's faces.¹⁴⁸

¹⁴⁴ Transcript of telephone conversation (not classified) between FRG Finance Minister, Schmidt, and the President's Assistant for National Security Affairs, Kissinger, 5 March 1973; Rasmussen, Foreign economic policy, 101-04

¹⁴⁵ EEC Finance Ministers had met on 4 March 1973 and rejected the FRG's proposal for a common float. At Giscard d'Estaing's suggestion, they agreed instead to convene a G10 meeting reinforced with Swedish and Swiss participation on 9 March. Despite this set back, Brandt continued to push for a joint float. Schmidt rated its chance of success more highly than the US Treasury had, but still "less than 50%": the Germans felt France, Italy and the UK were making problems for Brandt's efforts (Solomon, International monetary system, 232).

¹⁴⁶ Transcript of telephone conversation (not classified) between FRG Finance Minister, Schmidt, and the President's Assistant for National Security Affairs, Kissinger, 7 March 1973; Rasmussen, Foreign economic policy, 113-15

¹⁴⁷ Ibid., 115

¹⁴⁸ Burns, a staunch advocate of fixed exchange rates, was perturbed when he learned what Nixon and Kissinger were attempting as a result of Brandt's 2 March letter (Confidential letter from Chancellor Brandt to President Nixon, 2 March 1973; Rasmussen, Foreign economic policy, 49-50). Nixon had sent Burns, along with other members of the Quadriad and Volcker, to discuss the Brandt letter with Kissinger on 3 March 1973. Burns recorded in his diary that Kissinger "after reading Brandt's letter, spoke without any doubt: what we had to do adroitly is to

When the end of the fixed exchange rate system is discussed, most scholars give the “honour” of administering the *coup de grace* to Shultz on 16 March. In fact it was Kissinger in his 7 March telephone conversation with Schmidt. Kissinger was at the centre of the tangled web that constituted US foreign policy and foreign economic policy, and he was pulling the strings. He prioritised bringing order to US foreign policy and consistency across both political and economic domains. And, as an ideological Realist, he was willing to sacrifice economic objectives for security. He did not care, as Burns, Shultz, Stein and Volcker did, whether the international monetary system was based on fixed or floating exchange rates. He did not care whether, when faced with Mundell’s trilemma, the US prioritised capital mobility over capital controls. What he cared about was that EEC states should be encouraged to weaken themselves relative to the US by adopting a doomed joint currency float. Kissinger expected a failed joint float to break European monetary union, leading to recriminations and divisions within the EEC. This would damage EEC states’ self-confidence and unity, leaving them less able to resist the US on the MBFR, European Security Conference, NATO and Year of Europe issues. Kissinger’s diplomacy represented a deployment of US negative structural power, not positive structural power¹⁴⁹. Moreover, it was aimed at achieving Realist security objectives, not liberal economic objectives as claimed by scholars advocating structural power explanations of the end of fixed exchange rates.

Termination of the fixed exchange rate system and its replacement by a floating rate system was effected through a messy series of meetings in Europe

throw a wrench into the Common Market machinery, for European unity in the economic area would definitely work against US interests” (Burns and Ferrell, Secret diary, 94).

After meeting the Quadriad, Kissinger, accompanied by Shultz, went to see Nixon to discuss Brandt’s letter. It appears Burns was tipped off about the outcome of the Nixon/Kissinger/Shultz meeting by Volcker: Burns described Volcker as having come to see him “quivering” and needing calming because of his anxiety about Nixon’s and Kissinger’s reactions to Brandt’s 2 March letter on Europe’s response to the February/March foreign exchange market crisis. Burns, commenting on Volcker’s visit and international monetary policy developments in early March, recorded in his diary entry for 3 April 1973: “I’m concerned about a possible effort by Nixon and Kissinger to corrupt the monetary system because of some scheme of theirs, not clearly thought through, of breaking up or at least causing difficulties for the Common Market” (Burns and Ferrell, Secret diary, 95).

¹⁴⁹ Negative in the sense the US refrained from intervene in foreign exchange markets to sustain the fixed exchange rate structure Volcker had negotiated in February 1973.

As argued above, Kissinger, being indifferent to floating and fixed exchange rates, and believing any exchange rate arrangements would be merely temporary pending the outcome of the C20 negotiations, was not attempting to create new international monetary structures.

during 9-16 March, attended by Shultz, Burns and Volcker. At their 9 March G10 meeting Finance Ministers could agree only to ask their Deputies to create a design for an orderly exchange rate system and, moreover, to produce it for a follow-up G10 meeting to be held on 16 March. When pressed, Shultz said the US would “consider sympathetically” the idea of a common EEC float.¹⁵⁰ This confirmed for all nine EEC states what the FRG, the driving force behind the joint float initiative, knew already from Kissinger. As the G10 Deputies struggled unsuccessfully with their impossible task, EEC Finance ministers met separately on 11 March. The FRG prevailed persuading the EEC’s Snake-members a joint float was the most pro-European solution because it maintained fixed exchange rates within the Snake. The six Snake members accepted this, but only after the FRG had agreed to appreciate its deutschemark 3%.¹⁵¹ Volcker reported to Washington on 13 March the G10 Deputies had admitted they could not produce a new design for an orderly exchange rate system unless the Eurodollar market were tamed, and he had rejected European demands for the US to regulate it.¹⁵² The G10, plus Denmark, Ireland, Luxembourg and Switzerland, reconvened briefly on 16 March to declare all would float their currencies indefinitely, pending C20 agreement on the international monetary reforms needed to restore a fixed exchange rate system.¹⁵³

¹⁵⁰ Volcker and Gyohten, *Changing fortunes*, 112-113.

¹⁵¹ Ireland, Italy and the UK continued to float their currencies independently of the EEC6 (Belgium, Denmark, France, FRG, Luxembourg, and the Netherlands). The 3% appreciation was a small price for the FRG to pay to get its way. It had threatened to float unilaterally if others did not accept its joint float proposal (see Gray, “Floating the system”).

¹⁵² The G10 Deputies’ discussion centred on the policy choices Mundell had identified in his trilemma. With all G10 states wishing to retain national monetary policy independence, a choice had to be made as to whether the international monetary order would operate on the basis of fixed exchange rates or free capital mobility. They could not have both. European Deputies wanted fixed exchange rates, which would necessitate controls on capital mobility. But European states and their central banks did not have the power to constrain the Eurodollar market: only the US had that power because it was, after all, a market for US-issued dollars populated to a large extent by US-based banks, even though most of its transactions were booked in London. Once Volcker had made it clear the US would not curb the Eurodollar market’s freedoms, leaving capital internationally mobile, European states had to accept they had no option but to float their exchange rates against the dollar, jointly in the case of the states in the European monetary union. Volcker’s reported the outcome of the G10 Deputies’ discussions to Shultz, who was by this time in Moscow, accompanied by Helmut Sonnenfeldt. Volcker’s message is incorporated in the secret backchannel message from National Security Council staff member, Sonnenfeldt, to the President’s Assistant for National Security Affairs, Kissinger, 13 March 1973; Rasmussen, *Foreign economic policy*, 120-22.

¹⁵³ *Ibid.*, 125.

Kissinger telephoned Treasury Deputy Secretary William Simon to discuss this outcome and seek reassurance the EEC's float would fail.¹⁵⁴ Simon assured him EEC splits were visible already, with Italy, Ireland and the UK outside the common float. Commenting on the six who had agreed to float, Simon added "I don't know how they can work that out, I truly don't." A satisfied Kissinger relaxed, but only a little:

"... we've put ourselves in a good strategic position. We couldn't bust the Common float without getting into a hell of a political fight... But we should create conditions in which the Common float is as hard to work as possible."¹⁵⁵

Simon assured him a policy of continued US non-intervention should suffice, although it might be necessary to intervene on occasion "to help some people but not others", thus straining the EEC currency snake's cohesion. Kissinger asked Simon to supervise this policy personally, adding "I mean, quite seriously, I don't want this handled as a technical-economic matter... I think from now on we have to throw our weight around to help ourselves. And then they'll start paying attention to us again."¹⁵⁶ Simon agreed the Treasury would do so. He was as good as his word: James assessed Shultz's Treasury was "as unhelpful in maintaining the new parities as could be imagined" as a result of its refusal to intervene in foreign exchange markets to help stabilise exchange rates and by emphasising its intention to end US capital controls by the end of 1973, creating the prospect of additional and potentially destabilising private capital flows.¹⁵⁷

Conclusions

Two decisions taken in Washington in February and March 1973 changed the international monetary order's basis. The decisions to end US capital controls by 1974 and encourage the EEC's into a joint float - ushering in generalised floating exchange rates - constituted a revolution when viewed from

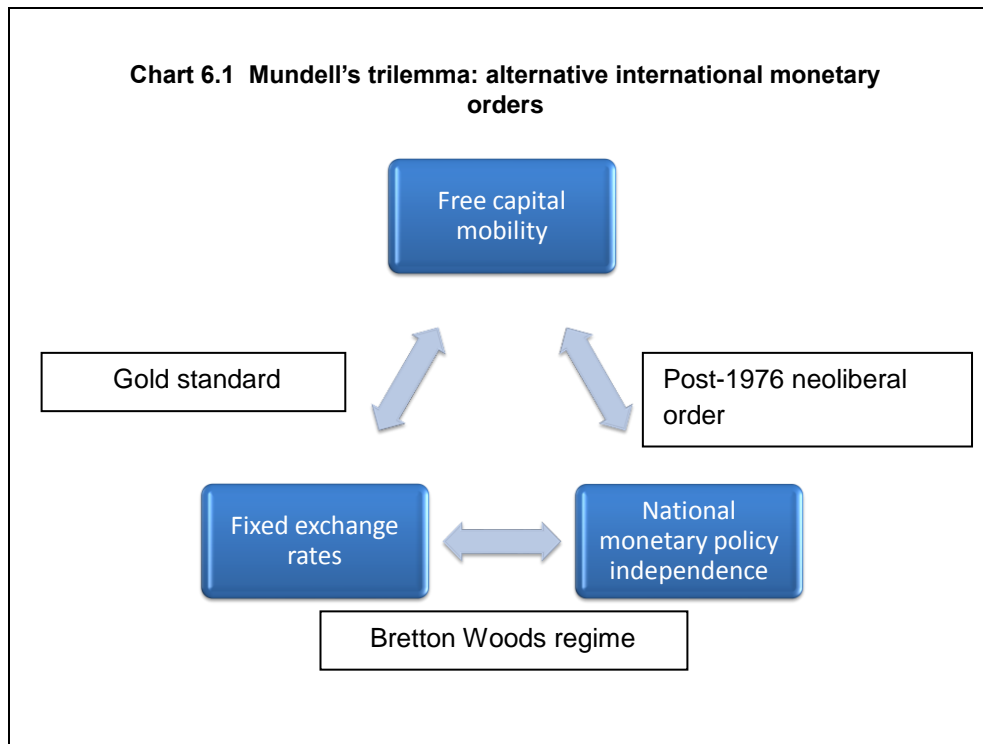
¹⁵⁴ Rasmussen, Foreign economic policy, 125-26

¹⁵⁵ Ibid., 126

¹⁵⁶ Ibid.

¹⁵⁷ James, International monetary co-operation, 242

the perspective of Mundell's trilemma (Chart 6.1). The international monetary order's foundations shifted from fixed exchange rates and capital controls to a new combination: floating exchange rates and free capital mobility.



The decisions did not appear significant at the time: almost everyone expected the C20 negotiations to replace the seemingly temporary expedient of generalised floating with a new international monetary order based on fixed exchange rates; and the IMF's *Articles of Agreement* permitted states to adopt national capital controls, which most then did. But the US' decisions pointed the way to how the international monetary order would evolve. We live with the consequences of those decisions.

Scholars generally explained the decisions in one of three ways:

- they were taken as a result of US strength and Washington's determination to promote US economic interests by creating a new international monetary order;
- US economic weakness left it unable to sustain an international monetary order based on fixed exchange rates. States therefore had no option but to adopt floating rates and (eventually) capital mobility; or,

- the US decisions were precipitated by external economic factors, such as the emergence of powerful international capital markets and design flaws in the Bretton Woods regime pertaining to liquidity-creation and balance of payment adjustment.

I assess, on the basis of accessing archived materials, all three explanations are wrong.

Theorists who argue the US used its strength - its structural power - to create a new international monetary order based on floating exchange rates ignore the evidence of the US using its power to remain within a fixed exchange rate order during 1971-March 1973 and that Washington was seeking to build a consensus in the C20 negotiations in favour of basing the reformed international monetary order on fixed exchange rates. As long as the US Foreign Economic Policy Executive was taking decisions on supporting a fixed or floating exchange rate-based order using purely *economic* criteria, the US consistently supported fixed exchange rates. Whenever push came to shove on exchange rate policy, as in November 1971, February 1973 and even 3 March 1973, Nixon sided with Burns and Volcker within the Foreign Economic Policy Executive and backed fixed exchange rates. Nixon also backed Shultz's and Volcker's plans for reforming fixed exchange rates, the plan Shultz outlined at the IMF Annual Meeting in 1972 and which formed the basis of the US' proposals in the C20 discussions during 1972-74. This evidence contradicts the claims of theorists who argued the US used its structural power to destroy the Bretton Woods regime and replace it with a new international monetary order based on floating exchange rates in March 1973.

Yet Shultz acquiesced in March 1973 when European Finance Ministers asked if he would object to the EEC adopting a joint currency float against the dollar. Was this driven by US weakness, as some scholars contend? Far from it. The Nixon administration favoured fixed exchange rates over floating rates whenever the *economics* of the choice was considered. However, when the issue was addressed using purely *political* criteria, as in March 1973, US foreign economic policy objectives were subordinated to US foreign policy objectives. This is one of this thesis' original insights.

Archived materials not previously highlighted by scholars reveal how Nixon and Kissinger, free from the influence of strong domestic political

pressures on the matter, prioritised US security interests over economic interests, as neoclassical realists would expect. The White House saw an increasingly powerful, cohesive and assertive EEC as an obstacle to obtaining what it wanted for the US in forthcoming international security negotiations. Nixon and Kissinger gambled they could improve US chances of success in the security negotiations if they first weakened their EEC allies. They believed EEC states could not successfully manage a joint float; its failure would throw the EEC into disarray, enabling the US to play “divide and rule” and strengthen its hegemony. So the US held back from intervening in foreign exchange markets to defend fixed exchange rates - exercising its negative structural power - and lured EEC states into a joint float in March 1973, creating generalised floating in the process

Nixon and his Foreign Economic Policy Executive intended generalised floating to cause short-term political havoc for the EEC, not form the basis of a new international monetary order. Order-creation was Shultz’s and Volcker’s task in the C20. Generalised floating was expected to be only temporary because the C20 was expected to create a new international monetary order based on “fixed but adjustable” exchange rates by June 1974. Thus the widespread and prolonged use of floating exchange rates was the unintended consequence of Nixon’s and Kissinger’s pursuit of US security interests.

Nixon’s foreign policy towards the EEC was not that of a fading hegemon unable to defend its interests. Nixon and Kissinger believed they could strengthen the US’ relative power and hegemony by creating a monetary crisis for the EEC, even if that meant temporarily sacrificing the fixed exchange rate system Nixon had supported since taking office. Luring the EEC into a doomed joint float involved risks: Nixon could not dictate the outcome of his policy. Connally’s failed hegemony by domination tactics in 1971 had demonstrated the US lacked the positive structural power needed to impose its will on others in the trade, security and monetary spheres, but retained sufficient negative structural power to defend its interests. Nixon’s policy was the kind of calculated gamble Gowan expected the US to undertake occasionally to

reinforce its hegemony¹⁵⁸. Thus scholars claiming US weakness explained Nixon's decision to acquiesce in generalised floating are unconvincing.

Nixon's decision to end US capital controls was also motivated by politics, not economics. He had committed himself to abolish President Johnson's capital controls during the 1968 presidential election campaign and had pledged this without much thought for, or understanding of, its economic or systemic implications. He had simply wanted to differentiate his electoral offer from his opponent's by asserting he would put America First by over-riding other states' opposition to US capital outflows and take back the freedom to invest abroad US multinational companies and banks had enjoyed since 1945. In office, Nixon held off redeeming his pledge as long as he was advised by the Foreign Economic Policy Executive that allies would object. But it had to be redeemed at some point. It is significant Nixon did so only when Shultz confirmed Europe and Japan would not object: ending US capital controls had been agreed with them as part of Volcker's February 1973 devaluation package. With this political obstacle removed and the economic implications of the policy of little interest to him, Nixon was happy to authorise Shultz to remove the controls at the end of 1973.

And that is how the two central pillars of our neoliberal global monetary order were put in place in 1973: more by accident than design.

¹⁵⁸ See Gowan, *Global gamble*

Chapter 7

The C20: the (almost) Forgotten Negotiation

“We can’t afford a blow up in the monetary area since it affects relationships in the non-Communist world. Without reform there will be a blow up.”

Henry Kissinger¹

“...we need to go beyond a simple patching up of the Bretton Woods system.”

Richard Nixon²

“... a multilateral monologue”

Dr. C. J. Oort³

Chapters 4-6 focussed on Washington’s attempts to strengthen its hegemony by changing other states’ behaviours to its advantage within the international monetary system. This chapter switches the focus completely, from US attempts to change the international monetary *system* to its efforts to strengthen US hegemony by redesigning the international monetary *order* that shaped the state behaviours constituting the system.

This chapter draws heavily on US and British archived materials to provide a detailed analysis of the C20 international monetary reform negotiations. The archived materials generate original perspectives on US objectives and tactics, including Kissinger’s previously unreported role in halting progress in the C20 negotiations at a critical juncture, and on the interplay between US and European C20 diplomacy. These insights challenge the

¹ Remarks in conversation with Arthur Burns and Robert Hormats; Secret Memorandum of Conversation, 25 July 1972; Duncombe, Foreign economic policy, 639-43

² Confidential letter from the President to Prime Minister Heath, 10 July 1972; Duncombe, Foreign economic policy, 629

³ Oort, the Treasurer-General of the Dutch Ministry of Finance and Dutch C20 Deputy, was asked to mark Jeremy Morse’s contribution to international monetary reform in a speech to a dinner held to celebrate the conclusions of the C20 negotiations. Oort commented ruefully on how states had talked passed each other in the C20 negotiations, not to each other.

narrative adopted by structural Realists and some Marxists to explain the US' approach to international monetary reform in the C20.

Nixon delegated international monetary reform to Shultz and Volcker.⁴ They were not revolutionaries. They simply wanted to adapt the Bretton Woods regime to deal with what they saw as its main technical weaknesses: the two asymmetries in the adjustment process that put the entire onus for adjustment onto states running balance of payments deficits and prevented the US from depreciating the dollar unilaterally; and the lack of automaticity in the adjustment process that led to adjustment decisions being politicised and delayed. Their plan was intended to eliminate these problems and facilitate a return to US current account surpluses, enabling the US to cover its spending on military activities abroad and foreign direct investment and overseas aid.

Shultz and Volcker expected the new, reformed, international monetary order would be similar to the Bretton Woods regime and, like it, be based on national monetary independence and fixed exchange rates. They did, however, want the SDR to take on many of the dollar's Bretton Woods roles in the reformed order: the SDR would be the new order's numéraire; exchange rates would be fixed against the SDR; and payments imbalances would be settled mainly in SDRs. The US would lose its seigniorage privileges when it no longer printed the world's reserve currency, but it would gain the freedom to depreciate (or appreciate) its currency other states had enjoyed under Bretton Woods. Shultz and Volcker wanted to retain the IMF and the US' privileges within it. The IMF would provide the forum for agreeing new issues of SDRs (and thus global liquidity creation). Once other states had accepted the US' vision for a new international monetary order, the US would restore gold convertibility.

Shultz and Volcker, adopting hegemony by consensus tactics, were on the brink of success in the C20 negotiations in summer 1973, only to fail comprehensively. Kissinger's (and Nixon's) attempt to weaken and dominate Europe by ruining its monetary union had yielded no results by summer 1973 and Kissinger had made little progress in his Year of Europe negotiations. Archived materials not previously highlighted by scholars reveal Kissinger saw

⁴ Burns was involved in C20 Ministerial meetings, but his contribution was limited, as will be demonstrated below.

the opportunity for leverage through linkage.⁵ He wanted to put pressure on Europe by preventing progress on European priorities - international monetary reform and restoring gold convertibility - until European negotiators stopped being “beastly” to him in the Year of Europe negotiations. Kissinger pulled rank on Shultz, telling him to delay reform in the C20 at the very moment it seemed possible to achieve international consensus on reforms that would satisfy US objectives. Schultz obliged, but the loss of reform momentum was fatal. Shortly after Shultz pulled down the shutters on reform - temporarily he thought - OPEC raised world oil prices sharply, changing everything.

OPEC’s actions redistributed political and economic power internationally. Higher oil prices enriched oil producers, in terms of their economic and political power at the expense of oil importers, and restructured the world economy. OPEC needed investment opportunities for the capital it earned with its massive trade surpluses; oil importing countries needed loans to tide them over. Increased capital mobility was therefore in everyone’s interests. The surfeit of dollars in G10 central banks’ reserves became a dollar shortage in the scramble to pay for oil imports.⁶ Fixed exchange rates were no longer viable in these circumstances; the C20 ceased to pursue their restoration, effectively killing the US reform plan. The US and Europe found themselves politically more divided than ever by their responses to OPEC.⁷ Finance ministers saw the writing on the wall and hastened the C20 negotiations to a “thin” conclusion in June 1974.

Most international relations scholars expect order-creation to be part of a hegemon’s job. Obstructed in the C20 by French-led European opposition, and trumped by OPEC, the US had failed to implement its plan to create a new international monetary order. The oil crisis threw the US’ hegemonic problems into sharp relief: the US could neither dominate in the C20 nor muster the

⁵ None of the relevant participants’ published memoirs and accounts I have seen draw attention to Kissinger’s crucial intervention. This underscores the importance of consulting archived evidence where available.

⁶ Oil prices were set in dollars, and transactions were paid for in dollars. Thus the increased price of oil significantly increased the demand for dollars. Wells observed OPEC had restored dollar convertibility, not into gold, but into “black gold” – oil (Wells, *Economist* in an uncertain world, 123).

⁷ Evidence of the limits to US positive structural power was provided when Kissinger attempted to organising oil-importing states into a consumers’ alliance to balance against OPEC’s oil market power. France blocked Kissinger’s strategy in the Washington Energy conference. US partners and allies struck their own bilateral deals with oil exporting states, leaving the US to deal alone with the Arab energy embargo.

consensus it needed to create and maintain a legitimate order in June 1974. The Foreign Economic Policy Executive became rudderless: Nixon's presidency hung by an impeachment-threatened thread. US failure in the C20, in part self-inflicted, contradicted those who argued the US triumphed by using its structural power to construct a new international monetary order. US failure provided some justification for scholars favouring hegemonic stability theory explanations for international monetary developments. Neoclassical realism provided a better explanation than either structural power or hegemonic stability.

This chapter is organised into twelve sections covering: a review of scholars' views of the US' performance in the C20; organising the C20 negotiations, January-September 1972; reform planning; European perspectives on reform; negotiating at a snail's pace, September 1972- April 1973; C20 optimism grows, May-September 1973; Shultz drives towards reform; France procrastinates; two noises off; Kissinger blocks reform; from Nairobi to a "thin conclusion", October 1973-June 1974; and, conclusions.

Scholars' Views on the US's Performance in the C20

Had Nixon and Shultz succeeded, what would a new US-friendly order have looked like? Surprisingly, this is a matter of controversy in international political economy literature.

Mundell's trilemma set out the essential economic constraints that must be respected when designing an international monetary order. Mundell's economic logic dictated policymakers should aspire to only two of the three desirable outcomes: the international monetary system would explode if they attempted to secure all three outcomes simultaneously. Markets understood Mundell's message and crashed Volcker's new, devalued, supposedly "fixed", dollar exchange rate within weeks of it being introduced in February 1973.⁸ Mundell's trilemma was not simply a theoretical construct. It had teeth. It could not be ignored. Choices would have to be made when designing the new international monetary order.

⁸ Discussed in chapter 6. The US had claimed it would abolish its capital controls by the end of 1973, establish a new, devalued exchange rate and run an expansionary national monetary policy that was incompatible with its fixed exchange rate.

What should Washington throw off the sledge? Domestic monetary autonomy? Fixed exchange rates? Free capital mobility? Washington's preferences would shape the contours of the C20 discussions and priorities. Nixon and his officials were never going to sacrifice US domestic monetary policy autonomy. Shultz had to finalise US plans for the new international monetary order's architecture in summer 1972, well before Nixon had secured re-election. Nixon regarded his re-election as his administration's paramount political objective and believed an expansionary US monetary policy was the key to victory. Retaining US monetary policy autonomy was therefore a given. This implied Washington's real policy choice for the new international monetary order in 1972 lay between fixed exchange rates coupled with on-going capital controls, as in the Bretton Woods regime, or - the more radical option - floating exchange rates with free capital mobility, as Milton Friedman, his academic followers and Treasury Secretary Shultz, were advocating. Which combination would best serve Washington's interests and strengthen US hegemony?

Many scholars, mainly Realists and Marxists - including Strange, Kunz, Seabrooke, Walter, Gowan and Panitch & Gindin (Table 7.1) - argued the answer was obvious, especially to Wall Street: US hegemonic interests would be best served by introducing free capital mobility and sacrificing fixed exchange rates.⁹ These scholars claimed Washington deployed its structural

⁹ Strange gave the lead to Realists and Marxists by introducing her concept of structural power in *Casino Capitalism*. She applied it to the process of creating a new international monetary order during 1972-76, arguing US policy was driven in part by US lobby groups, notably the Wall Street banks and US-based multinational companies, who wanted freedom from US and other states' capital controls, even if that meant accepting floating exchange rates (Strange, *Casino capitalism*, 22). Strange claimed the Ford administration delivered what they wanted in 1976. She declared: "It (the US) had to use its structural power to break the old rules and win new freedoms for itself" (Ibid., 67). Seabrooke took a similar line, arguing the US, at Wall Street's behest, "repelled" other states' attempts to strengthen capital controls and resisted their efforts in the C20 to replace the dollar with the SDR as the world's main reserve asset (Seabrooke, *US power in international finance*, 84-85). He argued (Ibid., 16) "... the US is by far the strongest state in international finance and has been able to shape the international financial system to its own advantage." And (Ibid., 17) "...the ability to shape preferences is more important than the accumulation of resources." In Seabrooke's view, the US "trumped" the C20 negotiations in 1973 by using its structural power to introduce floating exchange rates, and in turn found its structural power enhanced by Wall Street as US banks recycled OPEC's petrodollar surpluses to oil-importing states, ensuring the dollar had no rival as a reserve currency. Walter, like Seabrooke, took up Strange's concept of structural power to explain how the US had succeeded in fending off other states' effort to convert their dollars to US gold and their attempts to avoid adjustment by retaining fixed exchange rates: "Dropping gold, resisting others efforts to return to fixed or semi-fixed exchange rates was the exercise of structural power" (Walter, *World power*, 252).

Guzzini was relatively downbeat about the US' use of power to achieve its economic objectives. He argued Connally failed to win OECD approval for the US to run large current account surpluses, forcing Nixon switched to a new set of policy preferences - national

power successfully to achieve this objective and drove an unwilling international community to accept the necessary amendments to the IMF's *Articles of Agreement* in January 1976.¹⁰ Strange's structural power-based explanation of events has gained scholastic favour over time and is now arguably the

monetary policy autonomy and a floating currency - which the US achieved through amending the IMF's *Articles of Agreement* in 1976 (Guzzini, *Realism*, 151). Kunz, however, developed Strange's themes to an almost Panglossian degree: "The failure of the post-1971 search for order was a triumph for the Nixon administration" (Kunz, *Butter and guns*, 221). Kunz argued floating the dollar put no appreciable constraint on the US economy and protected US gold reserves while forcing smaller economies to adjust. Consequently, in Kunz's view, "(t)he US had achieved the best of all possible worlds - the benefits of systemic leadership without many of the burdens. What had been a gold and dollar standard evolved into a dollar standard" (*Ibid.*, 222).

A structural power explanation for the US' behaviour was music to Marxist ears. The picture of a US government acting to benefit important and well-connected capitalist constituencies - the people owning and running Wall Street's financial service providers and multinational companies - dovetailed with Marxist analysis. Gowan's, *Global Gamble*, and Panitch's and Gindin's, *The making of global capitalism*, for example, incorporated structural power into their analysis of neoliberalism's origins.

World Systems theorists may share fellow Marxists' views, but if so, there is a problem in discerning them. This is largely due to the relatively short period discussed here (1972-76). World Systems theorists tend to ignore the C20 completely as they skip over the details of events. Their approach is better suited to painting the big picture with a broad brush, not filling in details, such as the C20 negotiations, with a fine point. For, Arrighi and Wallerstein it sufficed to mention closing the gold window and financialisation's emergence; they do not discuss the specific causes.

Arrighi argued the emergence of a period of financialisation is the inevitable consequence of a hegemony entering its "autumnal" period, in which the hegemon finds itself with a surplus of domestic savings and needs to create the freedom for itself to invest this in capital accumulation abroad at the expense of other states' national interests (Arrighi, "Hegemony unravelling - 2", 84-85; see also Arrighi and Silver, "Capitalism and world (dis)order", 261)). He does not describe the details of how the US achieved this freedom for itself during 1969-76, limiting himself to broad brush references to the event, such as: "the abandonment of the gold-dollar exchange standard resulted in the establishment of a pure dollar standard" (Arrighi, *Long twentieth century*, 318). Wallerstein sees the international monetary events of 1969-76 in a similarly broad context and does not dwell on detail. He argues "The automaticity of the US economic advantage had largely disappeared by the late 1960s" and growing competition from Japan and Europe forced the US "to go off the gold standard" (Wallerstein, *Decline of American power*, 49). But Wallerstein does not appear to regard international monetary developments as especially important, either as a cause or symptom of declining US hegemony. For instance, he often does not mention international monetary affairs when analysing what he argues was the start of the downturn in US hegemony, which he dated from 1968-73 (see, for example, Wallerstein, *After liberalism*, 187-188, and his "Curve of American power", 81-84).

Not all Marxist scholars believe the US succeeded in achieving its objectives. Harvey, for example, as with some liberal scholars (see below), emphasised the confusion in international monetary policymaking at the time, with policymakers "stumbling" erratically towards solutions that were anything but pre-planned or foreseen. Harvey discussed the birth of neoliberalism, not the C20 itself: "But how were the conditions for the resumption of active capital accumulation to be restored? ... In retrospect it may seem as if the answer was both inevitable and obvious, but at the time I think it was fair to say no really knew or understood with any certainty what kind of answer would work and how. The capitalist world stumbled towards neoliberalisation as the answer through a series of gyrations and chaotic experiments that really only converged as a new orthodoxy with the articulation of what became known as the 'Washington Consensus' in the 1990s" (Harvey, *Brief history of neoliberalism*, 13).

¹⁰ Chapter 8 discusses how the amendments aligned the residual elements of the Bretton Woods regime with the needs of a world economy based on free capital mobility and floating exchange rates.

dominant explanation.¹¹ Many scholars now believe the US deployed its structural power to restructure the international monetary order - and international capitalism - to lay the foundations for a neoliberal world economy. The US economy - and US economic power and hegemony - benefited handsomely from this over time, not least because growing economic power underpinned Washington's ability to project US military, economic and diplomatic power abroad.

Table 7.1 US successful in the C20 negotiations? Selected authors' views.

Outcome	Realists	Liberals	Marxist
US unsuccessful	Gilpin (1977, 1987) Krasner (1977)	De Vries (1976) James (1996) Keohane (2005) McKinnon (1993) Moffitt (1983) Morse (1979) Nau (1992) Odell (1979, 1982) Solomon (1977) Webb (1995) Williamson (1977)	
US successful	Guzzini (1998) Kunz (1997) Seabrooke (2001) Sterling-Folker (2002) Strange (1986) Walter (1993)	Bennett (1975) Bundy (1998) Eichengreen (2008, 2012)	Gowan (1999) Harvey (2005b) Panitch & Gindin (2012)
"Don't knows"	Schmitt (1974)	Gray (2007)	Harvey (2005a)

While most Realists and Marxists saw the US as having succeeded during 1969-76, most Liberals saw it as having failed.¹² They saw Washington

¹¹ Harvey, for example, was uncertain initially as to what had prompted Nixon to close the gold window (Harvey, Brief history of neoliberalism, 13); subsequently he accepted the structural power-based explanation for US international monetary policy for the period 1969-76 and beyond (Harvey, New imperialism, 128-29).

¹² As in the Realist and Marxist camps, there were Liberal dissenters from the majority view, arguing the US achieved success. Eichengreen was dismissive of what he regarded as an unrealistic C20 process (Eichengreen, Exorbitant privilege, 62). He had earlier pointed out that central banks took until 1973 to learn they could not defeat foreign exchange markets'

as having set out to retain the Bretton Woods configuration of Mundell's trilemma, only to be forced to accept a new trilemma configuration: fixed exchange rates were sacrificed to secure global free capital mobility (Chart 6.1). Washington initially opposed this change; it therefore marked a US defeat.

The C20 negotiations, now largely forgotten, were the field of bureaucratic conflict on which the US attempted to hammer out an international consensus on a new international monetary order. Liberals stressed that Shultz, despite his ideological affinity with Friedman and floating exchange rates, pragmatically accepted other states were not ready for a new order encompassing floating exchange rates and free capital mobility. He set aside his ideology and worked to deliver a consensual new monetary order based on fixed exchange rates. His international monetary reform plan, proposed to the IMF in September 1972, called on member states to introduce a new Bretton Woods-like order combining continued national monetary policy autonomy with fixed (but readily-adjustable) exchange rates; states would be free to decide for themselves on capital controls.¹³ Shultz also offered to resume gold

challenges to fixed exchange rates, except at great expense (Eichengreen, *Globalizing capital*, 134-38). The growing sense that central banks could not control the Eurodollar market played into US hands, according to Eichengreen, because Washington had always been pro-floating and thus got what it wanted in the end. He observed France, not the US, had to make all the concessions that were needed to reach agreement at Kingston in 1976. (Eichengreen's arguments are unconvincing on both fronts. Archived material demonstrated the US wanted and lobbied for fixed exchange rates to be central to the reformed international monetary order. Washington regarded floating as an exceptional arrangement, possibly limited to serving as a temporary safety valve for currencies under market pressure. And, as will be demonstrated in chapter 8 with the aid of archived documents, the US had to make concessions to France on gold before it could obtain agreement on amendments to the IMF's *Articles of Agreement*.) Bundy also suggests the US succeeded in the C20 negotiations. He adopted primarily a non-economic perspective when analysing all aspects of foreign policymaking in the Nixon administration. This may explain why he mistakenly described Shultz's "fixed but adjustable" exchange rate proposal as: "In effect, a floating rate system with rules, obligations and penalties" (Bundy, *Tangled web*, 418). Williamson challenged the Liberal scholars' consensus on the significance of OPEC's actions in undermining the US' ability to conclude the C20 negotiations to its satisfaction: he believed OPEC's intervention provided no more than "the convenient alibi" for postponing the quest for a new fixed exchange rate order (Williamson, *Failure of world monetary reform*, 72). He regarded the Kingston agreement as a US success, but one ushering in a "non-system" instead of the international monetary order the US professed to be seeking.

¹³ This vision for the international monetary order was, of course, incompatible with the constraints identified in Mundell's trilemma once the US' monopoly over issuing global reserves had given way to an SDR-based system in which increases in global reserves would be decided multilaterally in the IMF. I found no archived evidence of Washington being aware of this. Nor do policymakers' memoirs and diaries reveal any contemporary or subsequent awareness of the point that retaining national monetary policy independence and adopting free capital mobility was incompatible with retaining fixed exchange rates. Mundell's insights appear to have been overlooked by Washington, even though economic policy advisers, such as Bergsten, were aware of Mundell and his work: see, for example, the numerous references to Mundell in Bergsten's *Dilemmas of the dollar*. Washington's lack of awareness of Mundell's insights perhaps explains

convertibility once the US' reform plan had been adopted. This would have delighted European states and given the new international monetary order credibility and legitimacy. It was not to be.

Kindleberger's hegemonic stability theory predicted international disorder would follow a hegemon's failure to impose its order on the world. The majority of Liberal scholars (and a minority of Realists) saw the US in this position in 1973 (Table 7.1): Watergate revelations had shredded Washington's legitimacy; the Vietnam War and OPEC's oil price increases and embargoes sapped US hard power.¹⁴ G10 states were uncertain whether co-operation with the US, including in the C20, was any longer in their national interests, leaving Shultz unable to muster a consensus supporting the US international monetary order reform plan.¹⁵ Thus the US failed in the C20 and failed to mobilise a united Western response to OPEC. International co-operation within the G10 broke down spectacularly as OPEC and financial markets, invigorated by their new role in selectively recycling oil surpluses to deficit states, imposed globally-significant political and economic structural changes. Liberals feared the lack of international co-operation had produced an international monetary "non-system" instead of a C20-organised comprehensive reform.¹⁶ Their downbeat

why members of the Foreign Economic Policy Executive were puzzled by market reactions to Shultz's simultaneous announcement of the February 1973 dollar devaluation and the administration's plans to abolish capital controls by the end of 1973. Markets understood the incompatibility of national monetary policy independence, free capital mobility and fixed exchange rates, even though US policymakers did not, and reacted to Shultz's announcement by undermining the notion that Volcker's negotiating skills had produced a new, durable set of fixed exchange rates for the dollar (discussed in chapter 6).

¹⁴ For Liberal views, see, for example: de Vries, "Non-reform of the international monetary system", 588; James, *International monetary co-operation*, 255; Morse, "Dollar as a reserve currency", 362; Nau, *Myth of America's decline*, 166; Odell, "Emergence of flexible exchange rates" and *US international monetary policy*; and Solomon, *International monetary system*, 259. The minority of Realists included Krasner and Gilpin. Krasner argued the US lacked the power it needed to win the outcome it wanted: "... the effective power the US can utilise is not sufficient to re-establish an international monetary system in which there is clear agreement on rules and norms... but no serious effort was made to construct a new order" (Krasner, "US commercial and monetary policy", 666). Gilpin believed the US had wanted to create a new order, but had been forced to settle for a "non-system" at Jamaica and, moreover, the US had failed to solve the adjustment problem satisfactorily, despite prioritising the issue: mercantilist states remained free after 1976 to use "dirty floating" to manipulate their floating exchange to super-competitive levels at the expense of US competitiveness, just as they had been free under the Bretton Woods order to run undervalued exchange rates (Gilpin, *Political economy*, 141-42).

¹⁵ Webb, *Political economy of policy co-ordination*, 149 and 161

¹⁶ See, for example, De Vries, "Non-reform of the international monetary system", and Solomon, *International monetary system*. Williamson title, *The Failure of World Monetary Reform 1971-74*, says everything about the Liberals' view. Paradoxically, Williamson regarded the US as failing in the C20 in 1972-74, but successful in obtaining its preferred amendments to the IMF's Articles in 1976.

assessment was well-founded and shared by William Simon, Treasury Secretary, a member of the Foreign Economic Policy Executive and an economic Liberal.¹⁷ He was relieved to be rid of the reform process at the time: “All’s well that ends”, he joked at a reception held to celebrate the IMF *Articles’* amendments in Kingston, Jamaica.¹⁸ The Jamaica Accord did not even merit a mention in his autobiography.¹⁹

The conflicting Realist/Marxist and Liberal scholars’ perceptions of US objectives and US hegemonic success or failure during 1969-76 were rooted in three factors: the role of historical perspective; inattention to the C20 negotiations; and the subsequent success of neoliberalism.

Many Liberal analysing the 1969-76 monetary events were writing at the time they took place or shortly thereafter (Table 7.1), and were attempting to explain why the US hegemon had failed to maintain international order. Realist and Marxist perceptions of 1969-76’s events generally did not surface until a decade or more had passed, when the US’ gains from globalisation and financialisation required explanation. Strange’s new concept of structural power and her analysis of its application during 1969-76 seemingly provided it.

The different scholarly perceptions of US success or failure may also have reflected a lack of attention to the C20 negotiations. The C20 and subsequent reform negotiations faced compelling, high-profile contemporaneous competition for scholarly attention.²⁰ And whereas the drama of Nixon’s abrupt coup of closing the gold window attracted much interest, relatively few scholars had the expertise or inclination to spend time analysing the C20’s technical, drawn-out international monetary negotiations.²¹

The eventual success of the neoliberal approach to international financial and monetary management may have biased perceptions. Neoliberalism’s

¹⁷ Simon was well-placed to judge these matters. He served as US Treasury Secretary in the latter stages of the C20 negotiations and participated in the IMF Interim Committee meeting in Kingston, Jamaica, that amended the *Articles of Agreement* in January 1976, concluding the order-building process. He was a well-briefed pro-market zealot, yet failed to recognise the fundamental importance of what had been agreed.

¹⁸ De Vries, “Non-reform of the international monetary system”, 577

¹⁹ Simon, *A time for reflection*

²⁰ Watergate, the end of the Vietnam War, the Yom Kippur Arab-Israeli war and OPEC’s oil shock

²¹ Compare the number of authors cited in Tables 2.1 and 7.1, respectively. Many of the scholars who engaged with the C20 approached the subject from a purely economic perspective, for example Argy’s *Post-war international monetary crisis*.

success, especially for the US, may have predisposed some scholars to believe it was the intended outcome of US policies. Gowan freely admitted to this.²² One would expect any such bias to produce a growing consensus in favour of theories, such as Strange's, that the US used its structural power to engineer an international monetary outcome favourable to itself.²³

The inaccessibility of important archived materials, the relative scarcity of academic literature on the C20 negotiations and the possibility of bias affecting some of what was written resulted in speculative theories clouding perceptions. However, controversies can be clarified now by searching the UK and US National Archives and the Bank of England's archive for original documents that illuminate the C20 negotiations.

Were perceptions clouded by theory? An issue facing all scholars who argue the US successfully managed international monetary reform during 1969-76 serves to illustrate the point: why was the date of Washington's supposed triumph in re-writing the international monetary rules to its advantage delayed until 1976? If the US possessed the structural power necessary to deliver reform in 1976, why did it not deliver reform earlier? Why should US policymakers have endured, in Strange's description, the "pantomime" of the C20 negotiation? Realist and Marxist scholars who tackle this awkward question have various explanations for the delay to completing reform.²⁴ These include: domestic interest groups seizing control of the US' agenda for their own purposes; a change of US objectives; deceit; and Shultz being over-ruled by others in the Nixon administration.²⁵ All are unconvincing, either as to the US'

²² Gowan states "... we must try to understand how the powers of (Western) states are being wielded and for what purpose: and this requires we don't take policy on trust. It also, I have found, usually requires delving into the detail and engaging in 'backward mapping': reading back from actual policy outputs to hypotheses about policy goals" (Gowan, *Global gamble*, x)

²³ Walter is representative, claiming that by the mid-1970s, "the US had largely succeeded in reshaping the international monetary system in a way seen as advantageous for America...financial integration has in many ways strengthened the transmission mechanism from US policies to other states..." (Walter, *World power*, 189-90)

²⁴ Not all do. Panitch and Gindin, in *Making of global capitalism*, for instance, gloss over the issue without explanation.

²⁵ In *Casino capitalism*, Strange claimed the US used its structural power successfully in August 1971 when Nixon suspended gold convertibility, and again in 1976 when it pushed through amendments to the IMF's *Articles of Agreement*. So why did Shultz not use this structural power to bring the C20 negotiations to an early conclusion? Flirting with ideas that would later be taken up by neoclassical realists, Strange argued US policymakers were influenced by private sector lobby groups, notably banks and multinational companies who undermined the reform plan Shultz put to the IMF in September 1972 and persuaded Washington to change its objectives. In the end, Strange believed, Shultz found he was

reasons for delaying a result it could have achieved rapidly using its structural power, or because scholars' explanations of the decision-making mechanisms at work are not credible in the light of the evidence now available from archives.

constrained by the political power of domestic lobby groups and was prevented from "giv(ing) up the (US') super-exorbitant privileges". The C20 and reform negotiations, in her opinion, became a "pantomime", buying time for the US until it could amend the IMF's *Articles of Agreement* in ways helpful to the US domestic lobby groups.

Guzzini and Kunz argued US policymakers, having carefully crafted a complex, coherent reform plan, changed their minds spontaneously part-way through the C20's attempt to agree a new order (Guzzini, *Realism*, 151, and Kunz, *Butter and guns*, 103). This, in their view, delayed international agreement and explained the substantive changes in the reforms. The explanation has some merit. International economic and political structures were changing in 1973; it would be odd if states' views did not also evolve to take account of this. Moreover, officials gained experience of floating exchange rates and found them less problematic than had been expected. In his opening statement to a joint hearing of the Subcommittee on International Finance of the House Banking and Currency Committee and the Subcommittee on International Economics of the Joint Economic Committee on 13 November 1973, Volcker said the world economy had been hit by major oil and agricultural price shocks in 1973, as well as by the introduction of "temporary floating", yet "(t)rade and investment continued to flourish. The atmosphere of repeated and continuing crisis has faded. Given the circumstances, could any other arrangements (than floating) have done as well?" (The text of Volcker's statement is included in the Bank of England archive file 8A 212/1). Furthermore, C20 negotiators made little headway on capital controls, creating fears a new fixed exchange rate order might be vulnerable to the destructive capital market pressures that wrecked Volcker's attempt to engineer a durable dollar depreciation in February 1973. Helleiner analyses this issue, focussing in particular on the work of the C20 sub-group "Technical Group on Disequilibrating Capital Flows" (Helleiner, *Re-emergence of global finance*, 106-21).

Sterling-Folker explains the US' change of mind differently, arguing states always prefer to act unilaterally because it gives them maximum policy freedom; if states act co-operatively, they invariably revert to unilateralism when circumstances permit (Sterling-Folker, *Theories of international co-operation*, 144). She regarded US co-operation in the C20 as no more than temporary, with the US reverting to independent, unilateral action when circumstances allowed in 1973.

Seabrooke and Walter argued deceit was involved: they believed the US always held objectives that differed from those in Shultz's original plan. Seabrooke states the US "repelled" its partners' efforts to strengthen capital controls and replace the dollar with the SDR as the international monetary order's main reserve currency; and the US used its structural power to introduce floating exchange rates in March 1973, a move which "trumped" the C20 negotiations (Seabrooke, *US power in international finance*, 84-85). Walter cites the example of the US "dropping gold" and resisting other states' efforts to restore fixed or semi-fixed exchange rates as examples of the US' successful use of its structural power (Walter, *World power and world money*, 252). In fact Shultz proposed and sought a return to both gold convertibility and fixed exchange rates.

Gowan argued Shultz was not being deceitful: he was over-ruled by others in the Nixon administration who were working actively outside the C20 conference rooms to thwart his reforms: "...it is now clear the Nixon administration had no intention of going along with such a scheme (to replace the dollar's reserve role with the SDR) or with respecting the consensus of the conference. It was using the whole exercise as a means of buying time while it imposed its own will on events outside the (C20) conference discussions. (With oil prices quadrupling) all the conference participants realised that collective planning of a new consensual international monetary order was dead and the whole negotiation fizzled out" (Gowan, *Global gamble*, 20). Gowan was onto something here, as will be demonstrated below, but he both overstated the case: in "overruling" Shultz, Kissinger was intended to delay, not terminate, Shultz's progress. Moreover, Gowan ignored the evidence of Shultz and Volcker doggedly pursuing the plan Shultz had taken great pains to agree with fellow members of the administration in summer 1972, and which Volcker pursued in the C20 as late as December 1973 (see below).

Rising oil prices changed international political and economic structures in 1973.²⁶ The need to deal with this adds some weight to Realist arguments suggesting US negotiators changed their minds about what they wanted. Negotiators could not afford to let their thinking stand still: the ground was shifting beneath their feet! However, Solomon observed the contrary.²⁷ From his privileged position in the “Bureau” (i.e. secretariat) servicing the C20 Deputies meetings, he commented “everybody wants reform, no one wants change”.²⁸ Whereas some Realist scholars fell back on arguments suggesting US and C20 negotiators had changed their minds about what they wanted, Solomon believed the real problem was that negotiators, were *not* changing their minds.²⁹ The inflexibility became damaging in 1973 when the C20 was overtaken by outside events.

²⁶ Economically, the consequences were felt in terms of a deep recession in the world economy, high and uneven rates of inflation in industrial countries and huge international payments imbalances that required capital to be recycled from oil exporting to oil importing states. Politically, the US’ sudden inability to control the world oil market saw power redistributed away from the industrialised world towards the oil-rich USSR and OPEC, and their Third World allies. These political and economic developments rendered the original Shultz/Volcker plan for international monetary reform redundant in the short-term: the uncertainty and volatility in world markets made it difficult for foreign exchange markets or central banks to value currencies, let alone fix a rate for them for the long-term. The need to finance oil importing countries’ current account deficits created an imperative for states to access to internationally-mobile capital, so capital mobility became more important to states than fixed exchange rates. The shift in power towards OPEC, which prior to the oil price increases had forged a tight alliance with other developing countries in the C20 negotiations, required industrial countries to pay more attention to their demands for increased resource transfers from rich to poor states and new governance arrangements in the IMF and World Bank, neither of which featured in Shultz’s 1972 reform plan.

²⁷ McKinnon provided a further Liberal explanation for US failure in the C20, emphasising the logical incoherence of Washington’s reform plan (McKinnon, “Rules of the game”, 26). Judging the US plan from the perspective of Mundell’s trilemma, McKinnon argued the US’ economic objectives were mutually incompatible. The US’ vision for the new order assumed it would be possible for any and all participating states to combine domestic monetary policy autonomy with fixed exchange rates and free capital mobility – all three simultaneously. As Mundell had pointed out, this was logically impossible: states could choose any two of these three objectives, any combination of which would preclude the third objective. The US’ plan was therefore doomed, in McKinnon’s view: US failure in the C20 was guaranteed even before Shultz and Volcker attempted to persuade their reluctant C20 peers to accept Washington’s plans. McKinnon’s critique is valid from an economic point of view, and the US reform plan would almost certainly have failed for the reasons McKinnon identified had it been put into practice. But it was never implemented and I have found no evidence of other delegations refusing to accept the US reform plan because it was incompatible with Mundell’s trilemma.

²⁸ Solomon, International monetary system, 259

²⁹ The fact that Volcker was desperately attempting to rescue the US reform plan in a Working Group meeting in December 1973 (i.e. well after OPEC’s actions had made the plan redundant) serves to illustrate Solomon’s point: C20 negotiators were not sufficiently intellectually nimble to keep up with a changing world. Perlstein included Nixon and Kissinger among the stick-in-the-muds. He argued Nixon was fixated on his forecast of an emerging multipolar world that did not include any developing countries among its Great Powers. Perlstein records Pompidou warning Nixon of the risks of Arab states using oil as a weapon. Pompidou’s warning was issued in June 1973, less than four months before OPEC ended the

Finally, if, as argued by some advocates of structural power explanations, the US changed its objectives markedly between the start of the C20 negotiations and the 1976 amendments to the IMF's *Articles of Agreement*, what does this tell us about the nature of US structural power? The concept of structural power is obviously valid and often useful, but is that power homogeneous, or does it disaggregate into "positive" and "negative" structural power? Scholars regard it as homogeneous, but this may have led them to misapply the concept to the C20. Did the US possess the structural power needed to change the international monetary rules in 1969-76? If it did, was the C20 a case of the US simply failing to convert its power into the desired outcome? (Nixon's Secretary of State, William Rogers, observed "the United States never lost a war or won a conference".³⁰) Strange and her followers do not discuss this possibility. Or was the C20 an example of the US possessing only partial structural power: sufficient to block Europe's attempt to introduce its own version of a new international monetary order (i.e. negative structural power), but lacking the positive structural power to install the new order Washington wanted? This too is overlooked by Strange and her followers.

Organising the C20 Negotiation, January-September 1972

The G10's Smithsonian Agreement included a commitment to reform the international monetary order. Two organisational questions had to be settled before reform negotiations could start: in what forum would the negotiations take place, and who would lead them? It was soon clear the US would not have things all its own way: Washington failed to impose its choice of forum and failed in its choice of personnel for committee leadership and the secretariat.

Connally, having failed in 1971 to get the large dollar devaluation he believed the US needed, was in no hurry to initiate reform discussions with G10

era of cheap energy. Nixon dismissed French concerns, as he had earlier dismissed a similar warning from Brandt, claiming the world's economy was governed by a fist comprising "the five fingers – a strong Europe, a strong US, Russia, China and, for the future, Japan... the rest do not matter." Perlstein claims Kissinger, too, ignored warnings from National Security Council and State Department officials about oil being used as a weapon (Perlstein, *Invisible bridge*, 183-84).

³⁰ Quoted, for example, by Diebold, *Economic system at stake*, 170

colleagues in 1972. Indeed, nine and a half months were required simply to agree the forum for discussions!

Connally's was uncertain about the choice of forum, knowing only what he did not want. He was averse to locating discussion in the IMF, whose staff he regarded as too independent of the US, but too knowledgeable to ignore; moreover, the IMF's governance arrangements did not match his criteria for these to be a "political" negotiation.³¹ Connally also opposed using the G10 - a Eurocentric and laborious "nine against one" format in his view.³² But he could not decide whether reform discussions should be held in a smaller or larger group. Volcker was similarly vague.³³ Connally decided to include at least one developing country in the negotiating group, believing he could rely on the developing world as an ally against conservative European states.³⁴ His thinking had not progressed beyond this when a British proposal won international support, effectively making the choice for him.

Lord Cromer, the British ambassador in Washington (and former Governor of the Bank of England), wrote privately to the British Chancellor, Barber, in April 1972 telling him Connally was dithering on reform. Cromer

³¹ The IMF was run by a Board of Governors who met annually. The Board comprised Finance Ministers of the states representing the IMF's 20 "constituencies". They could not be expected to bear the burden of reform negotiations: they had other commitments and anyway would need help from technically-expert officials. Executive Directors, who usually met twice weekly to handle the IMF's day-to-day affairs, had the technical ability to help the Governors, but they were usually senior officials, distant from national policymaking. For Connally's views and options on the choice of forum, see: De Vries, "Non-reform of the international monetary system", 584; James, International monetary co-operation, 244-46; Volcker and Gyohten, Changing fortunes, 115-16; and Williamson, Failure of world monetary reform, 60-61.

³² Connally's description, quoted in Shultz and Dam, Economic policy, 121. Connally observed in his memoirs "I was keenly aware we were a lone voice (in the G10)" (Connally and Herkowitz, In history's shadow, 248).

³³ Almost two months after the Smithsonian meeting, the FCO's Economic Counsellor in Paris, Derek Thomas, reported to HM Treasury that Connally was "dissatisfied" with the G10 format and was still mulling over the forum to be adopted for the reform discussions. Connally had said he wanted it to be smaller than the G10 and possibly to include only the US, Japan, a European representative and a developing country: a new G4 (Letter from Derek Thomas, British embassy, Paris, to Mrs R. E. J. Gilmore (HM Treasury) of 11 February 1972; Bank of England archive file OV53/42). The HM Treasury recipient of Thomas' letter highlighted the confusion in US Treasury thinking: Volcker had told them the US might want to use an *enlarged* G10 by including a developing country, probably Mexico (Letter from Mrs R. E. J. Gilmore (HMT) to Thomas (Paris) of 15 February 1972; Bank of England archive file OV53/42).

³⁴ Connally's belief appeared well-founded. Developing countries traditionally preferred to hold reserves in interest-earning dollar assets, not gold. And, like the US in 1972, they tended to run trade deficits and thus had an interest in establishing a monetary order which would help boost their exports to the states running trade surpluses with them. Obtaining developing country agreement to reforms affecting the IMF was essential: collectively they held enough votes to veto proposals in the IMF. Shultz observed "US officials hoped - mistakenly as it turned out - that an alliance between the United States and the less developed countries might be possible on at least some of the issues" (Shultz and Dam, Economic policy, 122).

observed Connally was “not on speaking terms” with the IMF or its Managing Director, Schweitzer, and wanted to steer international monetary reform discussions into another forum, but not the G10 or the “G20” (the 20 Finance Ministers on the IMF’s Board of Governors).³⁵ Replying to Cromer, Barber said he favoured the reform discussions being taken forward by a “Committee of (IMF) Governors” meeting at Ministerial or Deputy level as necessary.³⁶

Barber’s “Committee of Twenty” - the C20 as it became known - was an astute proposal. It was intended to create a more political version of the IMF, stripped of IMF bureaucracy. Finance Ministers meeting as the “C20 Ministerial” would have the authority to take political decisions collectively and, importantly, make them stick in their home capitals. Deputy Finance Ministers, meeting as the “C20 Deputies”, would be required to plough through the technical issues, but also confine their recommendations to the politically credible. G10 Deputies approved this approach in April 1972; G10 Ministers endorsed it in July, albeit with reservations.³⁷ The proposal was formally adopted by IMF members at their Annual Meeting in September 1972, who mandated the C20 to design a new monetary order to last for at least 25 years.

The IMF’s 1972 Annual Meeting selected the chairmen of the C20 Ministerial and Deputies committees. Indonesian Finance Minister Ali Wardhana, the retiring chairman of the IMF Board of Governors, was accepted as the logical choice to chair the C20 Ministerial committee. Chairmanship of the C20 Deputies committee was controversial. The US favoured Rinaldo Ossola, Deputy Governor of the Bank of Italy and respected for his work in the G10 Deputies committee. But US preferences were ignored; Jeremy Morse, an Executive Director at the Bank of England, was elected instead. It was agreed the C20 Ministerial and Deputies committees would be serviced by a secretariat, the “Bureau”. Morse led it, supported by four “vice chairmen”,³⁸

³⁵ Confidential and personal letter from Lord Cromer to Chancellor of the Exchequer, 4 April 1972 (Bank of England archive file OV53/42)

³⁶ Secret letter from the Chancellor of the Exchequer to Lord Cromer (Washington) of 11 April 1972 (Bank of England archive file OV 53/42)

³⁷ Otmar Emminger’s minuted the G10 Deputies meeting in London on 23 April. Volcker circulated it to his Group on 10 May as Confidential “Minutes of Discussion in London concerning procedures for Preparing Monetary Reform”; Duncombe, *Foreign economic policy*, 619-21. Volcker noted the G10 agreement (Volcker and Gyohten, *Changing fortunes*, 116).

³⁸ These officials reflected the IMF’s diversity: Jonathan Frimpong-Ansah (former Governor of Ghana’s central bank), Alexandre Kafka (Brazil’s IMF Executive Director), Hideo

The C20 Ministerial committee was intended to be the venue for political decision-making on reform; the C20 Deputies were responsible for resolving technical issues to the point where matters could be put to the C20 Ministerial for a political decision. C20 Deputies therefore carried the heavier burden, especially in the early stages of the negotiating process. Deputies held their first substantive meeting in November 1972 and met for three days, on average, every two months thereafter.

The Ministerial and Deputies committees were mass participation events, not venues for intimate discussion. Up to 180 people might be in the conference room.³⁹ The prospects for fruitful dialogue were further damaged by allowing up to 70 ministers and officials the right to speak.

The setbacks for the US over the choice of forum and C20 Deputies chairmanship were a warning: the US could not simply impose its preferences on the reform process. However, accepting the setbacks was an encouraging sign the US wanted international monetary reforms to have widespread legitimacy and was prepared to accommodate other states' views to obtain it.

Reform Planning

Volcker claimed the US reform plan Shultz announced in September 1972 was the only one on offer.⁴⁰ In his view, this demonstrated US leadership

Suzuki (Japan's former IMF Executive Director) and Robert Solomon (senior official, US Federal Reserve). The Bank of England's Edward ("Eddie") George was Morse's personal assistant.

³⁹ Volcker complained "there were about one hundred and fifty people in the room every time the Committee of Twenty deputies had a meeting. There were even more when the ministers met" (Volcker and Gyohten, *Changing fortunes*, 116). Williamson, *Failure of world monetary reform*, 68, lists the headcount for a C20 Deputies' meeting (C20 Ministerial meeting participation was similar):

- the 20 IMF constituencies each had two Deputies, one from its finance ministry, one from its central bank;
- their IMF Executive Director could also participate;
- each constituency could call on up to five Advisers;
- Morse's personal assistant, Eddie George;
- 2 IMF staff members at Deputy level, plus 3-4 at Adviser level;
- observers from international organisation: EEC, UNCTAD, OECD, GATT, IBRD, and BIS;
- IMF-provided secretariat services.

⁴⁰ "At no time did any other participant in the (C20) negotiation provide a similarly comprehensive vision of a new system... no other country seemed able to set out a view of a new monetary and trading system that would really attempt to take account of the needs of all the countries that would participate in it" (Volcker and Gyohten, *Changing fortunes*, 121).

and Washington's capacity to "take account of the international interest as well as our national interest."⁴¹ This is an overstatement. The British had a plan.⁴² The IMF staff quickly put forward their own reform plans.⁴³ Neither was

⁴¹ Ibid.

⁴² British Chancellor Barber put an outline reform plan to the IMF Annual Meeting in 1971. He envisaged a new monetary order in which the SDR replaced the dollar as the numéraire and main reserve asset. He proposed converting the dollar and sterling balances held in central banks' reserves to SDRs "over time". (The plan is summarised in an unclassified Bank of England "Brief for Mr Richardson on International Monetary Reform", prepared by the "Overseas Office" on 23 March 1972; Bank of England archive file OV 53/70).

Barber's plan would have dealt with two of the three "asymmetries" that were troubling the G10: the US' inability to revalue the dollar and the US' unique ability to create "primary reserve assets" by increasing the supply of dollars. The proposed switch to an SDR-based order would have required the US to value the dollar against the SDR, thus giving the US Treasury the freedom to appreciate or depreciate the dollar. The obligation to convert dollars held by foreign central banks to SDRs would at a stroke have nullified the US' seigniorage privileges that troubled European states. The third asymmetry, the unequal adjustment responsibilities of states in payments deficits or surplus, could have been incorporated relatively easily had Barber's plan been taken forward.

The US did not welcome Barber's plan. Officials argued it gave the US insufficient assurances on current account adjustment because it did not impose equal adjustment responsibilities on surplus and deficit states. Washington self-interestedly dismissed Barber's plan as a poor basis for negotiation, as a Bank of England official, J. A. Marshall, discovered when visited Washington and Ottawa in March 1972 to discuss the prospects for reform with his US and Canadian counterparts. Officials in Washington stonewalled, criticising the British reform proposals, but offering nothing constructive when asked about US views (J. A. Marshall, confidential Visits to Washington and Ottawa Report, 6-13 March 1972, circulated 20 March 1972; Bank of England archives file OV53/42). Mike Bradfield, the US Treasury's Assistant General Counsel for International Affairs, publicly rejected the UK's reform proposal in his speech to the annual meeting of the American Society of International Lawyers in April 1972 (undated letter sent in late April 1972 from K. J. Uffen, British Embassy, Washington, to Geoffrey Littler, HM Treasury; Bank of England archives file OV53/42).

⁴³ The IMF staff mounted its own initiative on reform in March 1972, circulating "*Reform of the International Monetary System – A Sketch of Its Scope and Content*" (SM/72/56 of 16 March 1972). The UK Delegation to the IMF reported (by telegram to London on 16 March) the IMF staff advocated a new order incorporating: prompter, smaller exchange rate adjustments; national currencies held as foreign exchange reserves to be converted into SDRs in future and outstanding balances of national currencies in reserves to be "consolidated" into an SDR account; foreign exchange market intervention to stabilise an exchange rate to be symmetrical in future (i.e. undertaken simultaneously by the central banks of the two currencies involved); "minor" currencies would be able to continue to peg to "major" currencies; the SDR would be the system's new numéraire and a competitive interest rate would be paid on SDR balances; gold would continue to be a reserve asset. The Executive Board discussed the *Sketch* on 22 and 24 March, during which, UKDel IMF reported, developing countries' Executive Directors pushed for an SDR/aid link to be incorporated in the new international monetary order. With US support, the IMF Executive Board rejected the *Sketch* as being unacceptably prescriptive; it called for the IMF staff to provide it with neutral advice on reform.

The staff duly circulated a new draft report on reform to the Executive Board in June. This simply catalogued the relevant issues and the advantages and disadvantages of different policy approaches. Nonetheless the US Treasury actively attempted to block the staff's work. Volcker had at last begun work on a reform plan to put to the IMF Annual Meeting; he did not want the IMF staff to steal his thunder by putting forward its own proposals. The US effort to block the IMF staff's work continued until the weekend the final IMF draft was sent for publication. US Executive Director Dale attempted to disrupt publication by demanding the staff insert 20 amendments as the final draft was being prepared for publication. He was fully aware their acceptance would both unbalance the Report's analysis and delay publication. This earned Shultz a letter of rebuke from French Finance Minister Giscard d'Estaing, sent on 31 July 1972 (Duncombe, Foreign economic policy, 644-45). Shultz responded in a confidential letter on 4 August 1972, adopting an air of injured innocence. But Shultz's reply mistakenly

acceptable to Washington. What would be acceptable was unclear initially: Connally had blocked all substantive work on reform in the Treasury. With a British plan already tabled and the IMF staff having presented their initial ideas for reform, the US Treasury was further embarrassed when Burns publicly presented his own unauthorised ideas on a US reform plan on 12 May. Treasury preparations did not begin in earnest until Shultz replaced Connally as Treasury Secretary in late May 1972.⁴⁴ Unshackled from the procrastinating Connally and spurred by Burns' unwelcome proposals,⁴⁵ Volcker scrambled

enclosed a note prepared by Dale listing his many attempts to obstruct and put pressure on the IMF staff, confirming French suspicions of American foul play! (Ibid., 651-54)

Despite the sustained US objections, the IMF staff could not afford to ignore international monetary reform. It was an existentialist matter for the IMF and non-US member states wanted to hear the staff's views. The IMF's Economic Counsellor, J. J. Polak, drove the staff's work forward, resisting US obstructionism. Polak's hand was strengthened when the US revealed it would veto any attempt to reappoint the IMF's popular Managing Director, Schweitzer. This boosted anti-US sentiment on the IMF Executive Board. Peter Bull, the Bank of England's representative in the UK Delegation to the IMF, wrote to Mary Hedley-Miller, a senior official in HM Treasury, on 22 August 1972 describing how the staff had spent six weeks and endured 40 Executive Board meetings discussing drafts of the *Reform Report* before it secured Board approval. Bull highlighted the US obstructionism, observing the US Executive Director, Dale, "made clear the US' disenchantment with the exercise and did not participate in the discussions." Bull noted the *Reform Report* was so even handed it could not even identify the reasons for the Bretton Woods regime's collapse, noting it could have been due to a lack of adjustment - the US' preferred explanation - or to US financial indiscipline - the French view (HM Treasury file T354/285 in the British National Archives). The Executive Board forwarded its final version, *Report of Reform of the International Monetary System*, to the Board of Governors in August 1972, publishing it on 6 September.

The *Reform Report* identified the issues on which decisions would be needed, but came to no conclusions. Instead it outlined the advantages and disadvantages of the various options policymakers might adopt. Unlike the earlier *Sketch*, it was not a fully-formed plan, but it contained all the necessary technical elements for inclusion in a reformed international monetary order, and showed how the IMF staff hoped member states would design the reformed order. It discussed exchange rates, convertibility and settlement of payments imbalances, the future role of reserve assets, "disequilibrating" capital movements and developing country interests in reform. (Its contents are summarised in Williamson, Failure of world monetary reform, 61-66.) It was well-received by most member states at the 1972 IMF Annual Meeting. De Vries assessed "hardly any further new ideas of importance were brought forward during the extensive reform discussions that ensued" (de Vries, "Non-reform of the international monetary system", 584). This was probably true, but the *Reform Report* was merely a technical and economic document, a watered-down version of the *Sketch*. It lacked the political perspective essential to shape the various economic elements into a coherent form that would pass political muster and be accepted by all states as a new international monetary order. Politics and power were essential ingredients for reform, but missing entirely from the *Reform Report*. Volcker had earlier reminded the bankers' conference in Montreal in May that international monetary reform would be shaped by, and must reflect, US power: Volcker told his audience: "The real challenge for US economic leadership is this: we need to make our case clearly and forcibly for new policies that will adequately reflect the balance of power" (Speech by Paul Volcker, to the American Bankers Association's annual International Monetary Conference, Montreal, 12 May 1972; Bank of England archive file OV53/42).

⁴⁴ Connally resigned on 16 May 1972.

⁴⁵ Frustrated by Connally's procrastination on international monetary reform, Burns took the initiative and gave the US position a firm shove in May 1972. Without Connally's authorisation, Burns presented a comprehensive 10 point reform plan in his keynote speech to the American Bankers Association's International Monetary Conference in Montreal on 12 May 1972. Volcker, who also spoke at the conference, objected to Burns' trespassing on Treasury

together a draft reform plan. Shultz refined it with the aid of non-Treasury Departments during summer 1972 and presented it at the IMF's Annual Meeting in September 1972.

Volcker was suspicious of Shultz at first, fearing his new boss was a "captive" of Friedman's thinking on economics.⁴⁶ Volcker expected Shultz to tell him to produce a reform plan based on floating exchange rates when Shultz first asked about the Treasury's work on reform in June. Volcker was surprised when Shultz prioritised pragmatism over ideology. Shultz instructed Volcker to prepare a plan for presentation at the 1972 IMF Annual Meeting, telling him it should be "something that has chance to work. A consensus."⁴⁷ Shultz evidently wished to build on the consensual approach to US hegemony that had resurfaced in the Smithsonian Agreement.

Volcker produced a draft plan for a new international monetary order, "Plan X", in July 1972.⁴⁸ It reflected Shultz's instruction to produce something "workable" and facilitate "a consensus". It attempted to meet US and European concerns about the Bretton Woods regime's shortcomings, notably the inherent asymmetries that had become politically unacceptable. The US' principle concerns were that Bretton Woods' design had left the US unable to devalue to restore competitiveness, and all adjustment pressures fell on states in balance of payments deficit, leaving the US balance of payments, as the international monetary system's "shock absorber", vulnerable to the collective efforts of the all other states to run balance of payments surpluses. Europeans saw things differently. They regarded the system's main asymmetry as being the US' unconstrained (and near-monopoly) power over reserve creation. Europe felt the SDR's introduction had done little to check US monopoly power.

territory and rebuked him at a press conference. Volcker recalled the incident: "The differing (US) perspectives on monetary reform were rather dramatically, if inadvertently, exposed at the annual International Monetary Conference of commercial bankers in Montreal of May 1972. Chairman Burns was on a panel discussing reform plans, and while his ideas were deliberately sketchy, they conveyed a tone of urgency... The press promptly interpreted his remarks as a clear change in the US position, moving closer to European views. By sheer accident, I had a press conference scheduled very shortly after Burns spoke, and aggressive questions were posed about 'the Burns plan'. I replied that Burns was not speaking for the US government... in any case we had no plan to present" (Volcker and Gyohten, *Changing fortunes*, 117).

⁴⁶ Volcker and Gyohten, *Changing fortunes*, 118

⁴⁷ Volcker recalled this discussion with Shultz in a conversation with Silber, quoted in Silber, Volcker, 111-12.

⁴⁸ Confidential Paper Prepared in the Department of the Treasury, *Major Elements of Plan X*, 31 July 1972; Duncombe, *Foreign economic policy*, 646-48

The US plan's main features were:

- the order would be based primarily on fixed exchange rates;
- rules-based "graduated pressures" would be applied to states running large payments imbalances;
- corrective action would be triggered by "adjustment indicators", which would be defined in terms of movements (up or down) in central banks' reserves;
- gold convertibility would be restored;
- the SDR would replace the dollar as the order's numéraire and main reserve asset;
- the dollar overhang in central banks' reserves would be eliminated gradually.

Plan X was intended to create a new order that would ensure prompt adjustment by surplus and deficit states, in part through facilitating greater flexibility in exchange rates than Bretton Woods had permitted, and in part through imposing penalties on surplus states that delayed adjustment.⁴⁹ Once a central bank's reserves had departed too far (up or down) from "normal" levels, adjustment action and penalties would be triggered automatically through what Volcker called "graduated pressures", i.e. the greater the departure from "normal" reserves, the greater the corrective action required.⁵⁰ The new order would be based on the SDR: the dollar's reserve role would be abolished except for "working balances" retained by central banks to facilitate international trade. Putting the SDR at the centre of the new order was

⁴⁹ Although it was assumed most states would fix their currencies at a par value against the SDR (Shultz stated this was the US' intention), Volcker envisaged greater exchange rate flexibility would be built into the new order than was permitted in the Bretton Woods rules. Wider trading bands around par would be permitted, 3-4% either side of par (compared to Bretton Woods' 1% either side of par, raised to 2¼% in the Smithsonian Agreement). And states would be permitted to float their currencies, either temporarily to identify a new and realistic par value, or indefinitely for states willing to relinquish all controls on capital flows or trade. (This latter point revealed Washington's ignorance of, or perhaps its lack of concern for, the constraints Mundell identified in his trilemma.)

⁵⁰ Volcker proposed defining a state's "normal" reserves in relation to its quota in the IMF. "Normal" might, for example, be defined as four times the size of a state's IMF quota. Adjustment and penalties would be triggered by states departing from normal reserve levels through a system of "graduated pressure". If the reserves of a state running balance of payments surpluses were to reach 150% of normal levels, it would be required to appreciate its currency by at least 3% annually; at 175% it would lose the right to convert national currencies in its reserves to "primary" reserve assets (i.e. gold and SDRs); and at 200% the state would be required to increase its overseas aid and liberalise its import regime, or its exports would be subject to a surcharge by importing states. States running deficits would be subject to similar graduated pressures, depending how low their reserves had fallen relative to "normal" levels.

intended to have two effects: it would enable the US to depreciate the dollar against the SDR, creating the same freedom of manoeuvre that other currencies enjoyed; and it would strip the US of its reserve-issuing powers, implying the US would face the same balance of payments constraints as other states. The dollar overhang in central bank reserves would be eliminated gradually by converting excess dollar holdings to primary reserves (principally SDRs, but also gold), effectively restoring gold convertibility.

This represented an extraordinarily balanced and generous first offer in the negotiating process. It went a long way to address European concerns about the dollar's privileges and gold, while at the same time addressing US demands for greater and speedier adjustment by deficit *and* surplus states.

It was, as Volcker later realised, almost exactly the same plan for symmetrical adjustment responsibilities that Keynes had put to White when they negotiated what became the Bretton Woods agreement.⁵¹ And it was, like Keynes' plan, received with suspicion - even hostility - by states running balance of payments surpluses.⁵²

European Perspectives on Reform

European states led the opposition to the US plan. British Chancellor Barber had rejected it before he even saw it. In a secret letter to the British ambassador to the United States, written in April, Barber confided "we cannot

⁵¹ Volcker and Gyohten, *Changing fortunes*, 120. Keynes' plan is described concisely in Gardner, *Sterling-Dollar diplomacy*, 92-93, and in detail in Steil, *Battle of Bretton Woods*, 137-47. Keynes proposed to call the institution that became the IMF the "Clearing Union".

⁵² Robert Hormats, a member of the NSC staff, produced an analysis of foreign media reaction to Shultz's IMF speech. Canadian media were perturbed by Shultz's proposals for the tough standards of behaviour to be applied both to states running surpluses and/or floating their exchange rates (as Canada was). Japanese and Australian reaction was hostile because of Shultz's threat of enforced adjustment for states running balance of payments surpluses. (Australia was benefitting from a cyclical upswing in commodity prices at the time.) The initial French media reaction was similarly critical, but softened once Giscard had welcomed the proposal to restore dollar/gold convertibility. Other European media generally welcomed the US' belated display of leadership. Media in developing countries complained of the lack of attention to development issues. (See Information Memorandum, classified Limited Official Use, from Robert Hormats to Kissinger, 3 October 1972; Duncombe, *Foreign economic policy*, 656-58)

Shultz's IMF speech, titled "Needed: a new balance in international economic affairs" was considered so significant at the time that its text was published in full by the *New York Times* the following day, 27 September 1972.

put the clock back to create Keynes' Clearing Union as the new role for the IMF".⁵³ Other EEC members also balked at Volcker's plan. Their objections were based on a different analysis of Bretton Woods' problems.

In Europe's opinion, Bretton Woods had been undermined by US financial profligacy made possible by the US' ability to issue the world's main reserve asset (dollars) at will. Any new international monetary order would need to deliver tighter US financial discipline than the Bretton Woods regime. Volcker's proposal to curb the dollar's privileges would go a long way towards achieving this and was welcomed by continental European states. But it did not go far enough. They wanted the SDR to be a "hard" currency: its value to be linked to gold (the French preference) or a basket of strong currencies (other continental EEC states' preference). Moreover, SDR assets should pay a rate of interest competitive with dollar-denominated assets. But there were divisions within Europe. The US and UK expected to be net debtors in SDR terms because both dollar and sterling balances held abroad would be converted to SDRs. Neither Washington nor London wanted a "strong" SDR that would make their debts more costly to service.

The balance between rules and discretion in economic policymaking marked a further substantive difference between the US and Europe. In the C20 negotiators' jargon, the US favoured a "tight", rules-based, adjustment system (centred on Volcker's proposed adjustment indicators, backed by graduated pressures on reluctant adjusters). The US wanted "tight" adjustment to be combined with a "loose", discretionary, approach to assets settlement.⁵⁴ The US believed the composition of national reserves should be decided on the basis of bilateral negotiations to determine the proportion of reserves to be held in national currencies for "working balances" purposes. In contrast, Europeans favoured a "loose", discretionary, adjustment system (adjustment indicators would signal merely the need to consider taking adjustment measures and not

⁵³ Secret letter from Chancellor Barber to Lord Cromer, 11 April 1972 (Bank of England archives file OV53/42)

⁵⁴ "Asset settlement" refers to the assets that are used to settle (i. e. pay for or fund) a state's overall balance of payments deficit. Under the Bretton Woods regime, imbalances could be paid for in national currencies (provided the currency was classed as convertible), gold or SDRs. The dollar's global acceptability as a means of payment created a privileged position for the US that no other state enjoyed: it could pay for its balance of payments deficits simply by issuing more of its own national currency. This involved no real resource costs for the US. Other states had to earn the dollars, gold or SDRs they needed to settle (fund) their balance of payments deficits, a real resource cost for them.

constitute a requirement for action), combined with a “tight”, rules-based, asset settlement system, with no (or minimal) reserves held in national currencies.

At the economic level, the US feared Europe and Japan would exploit a “loose” adjustment system to continue running trade and current account surpluses. Europe feared a “loose” asset settlement system would allow the US to retain the dollar’s privileges by using its power (on defence issues, for example) to persuade other states to hold large volumes of dollars in their reserves supposedly as “working balances”, thereby undermining financial discipline on the US.⁵⁵

At the political level, the US and European reform proposals had very different implications. By 1973 the US was running deficits attributable in part to its overseas aid, military spending and foreign direct investment abroad; it was, in effect, paying for its power projection policies by issuing dollars. Europe’s approach to reform would strip the dollar of its seigniorage privileges and maintain pressure on deficit states, including the US, to adjust. Adjustment would oblige the US to sacrifice domestic spending, through deflation or devaluation, to pay for its external policies. The US reform plan, however, allowed some scope for the US to continue to cover its deficits by issuing dollars that would accumulate as “working balances” in surplus states’ reserves, thereby obliging those states to share some of the resource costs of US external policies. The international monetary reform debate was as much about the future of US power - and who would pay for it - as it was about international monetary economics.

There were, of course, areas of international agreement as well as difference. US, Japanese and European views on exchange rates were almost identical. They differed substantively only as to how frequently exchange rates should change.⁵⁶ All believed exchange rates should normally be fixed, but adjustable – adjustable in the sense that a large, one-off appreciation or depreciation might be needed occasionally, as in the Bretton Woods regime. All agreed prior IMF approval would be needed to authorise large exchange rate

⁵⁵ There were precedents for this: Washington had earlier leaned on the FRG and Japan to persuade them not to convert dollars to gold, as was their entitlement under the Bretton Woods regime.

⁵⁶ Canada was the exception in the G10 in advocating flexible exchange rates from the outset of the C20 negotiations.

movements aimed at correcting “fundamental disequilibrium”. The US wanted small exchange rate adjustments to be more frequent than Japan and Europe were prepared to concede. The US also favoured slightly wider margins (within which a “fixed” exchange rate could move) than did Europe, and it wanted states to be free to adjust their exchange rate parity values by a few percentage points each year without prior IMF approval. All accepted temporary floating might be needed to help deal with foreign exchange market pressures.⁵⁷

The logics underpinning the US and European versions of the new international monetary order were quite distinct. Either approach, be it one based on tight adjustment or tight asset settlement, required many supporting measures, on which states’ views differed. A matrix created by John Kirbyshire during the C20 negotiations captures this (Table 7.2).⁵⁸

⁵⁷ In designing his Plan X with a view to maximising its chances of creating a consensus, Volcker had attempted to accommodate Canada’s needs. Canada had adopted floating as a way of life, not a temporary expedient. Volcker’s plan provided for this, subject to a state floating its exchange rate promising to avoid introducing capital controls or protectionist measures against imports. His intention was to raise the policy costs of floating as a means of dissuading states from adopting it other than for short-term needs.

⁵⁸ Advisor to the Governor of the Bank of England on international monetary affairs

Table 7.2 Summary of issues in the C20 negotiations, summer 1973⁵⁹			
	<i>US</i>	<i>Europe</i>	<i>Australia, Canada, Japan</i>
<i>Adjustment process</i>			
Exchange rates	Flexible unitary rules. No obligatory capital controls; presumption against permission for capital controls	Stable rates. Capital controls or dual markets if necessary to achieve stability	Australia: stable rates Canada: flexible unitary rates; no obligatory capital controls Japan: capital controls allowed
Indicators/graduated pressures	Reserve indicator prompts action. Total freedom of choice of adjustment policy instruments. Graduated pressures leading to sanctions if adjustment inadequate, e.g. trade restrictions	Presumptive assessment: consultation and recommendations on (choice of) adjustment policy instruments. Accepts graduated pressures "in principle" but wary of measures	All negative on indicators. Australia + Japan hostile on graduated pressures
Institutional issues	IMF applies indicators universally	IMF Board takes (most) decisions on adjustment and negotiates decision on liquidity creation	?
<i>Convertibility/liquidity control</i>			
Convertibility/asset settlement	Future convertibility only if adjustment process satisfactory (i.e. reserve indicator-based). Non-conversion permitted by bilateral agreement	Obligation of currency issuer to convert. Central to reform	A + C Little interest in convertibility; Australia opposes mandatory conversion by currency holder

⁵⁹ Based on a matrix prepared by John Kirbyshire that was attached to letter sent by C. W. ("Kit") McMahon, Bank of England, to Derek Mitchell, HM Treasury; 14 June 1973 (UK National Archives file T354/285)

Table 7.2 continued			
	<i>US</i>	<i>Europe</i>	<i>Australia, Canada, Japan</i>
Funding	Willing to discuss bilaterally. Will not concede onerous interest rates or valuation	Bilateral issue. Terms must be right for holder, including reversible in case of need	No interest
Substitution	Concerned over terms/costs. No reversibility!	Supports a “hard SDR” and a hard line on costs to the US. (Not UK)	No compulsory substitution
Liquidity control	Claims no need if reserves indicators adopted	Currencies in reserves should be constrained to “working balances”	Not a major concern
<i>Numéraire, SDR issues</i>			
Base of system	SDR	Strong SDR (France prefers gold)	Japan: strong SDR A+C: SDR sceptics
SDR interest rate	Nil or low	Competitive (not UK)	No clear views
SDR valuation	Weak	Must be strong (not UK)	No clear views
Future of gold	Remove from system – quickly!	Provides continuity; reactivate its use	Not a major concern

Negotiating at a Snail's Pace, September 1972-April 1973

Morse believed he would need - and be given - two years to produce a blueprint for a new international monetary order intended to last 25 years; he worked to this timetable. His methods were pedestrian and “Socratic”.⁶⁰ He would ask Deputies to participate in a general discussion of an issue. The Bureau (Secretariat) would identify areas of agreement and disagreement and remove the areas of agreement from the table. The disagreed issues were then put back to the Deputies for further discussion, informed by a Bureau document explaining the reasons for disagreement. Morse expected his process to whittle

⁶⁰ The description used by Solomon, a member of Morse's Bureau (Solomon, International monetary system, 237).

down the areas of disagreement over time: Deputies would talk themselves into a single view of how to tackle an issue. It did not work. The sheer size of the C20 Deputies meetings did not lend itself to a fruitful discussion and too many national positions were prepared in advance by negotiators unwilling to be flexible during the meetings.⁶¹ What Morse got was one Deputy after another reading their prepared statements of national positions, which underscored the differences of view. Oort, the Dutch C20 Deputy, dismissively described the C20 process as a “multilateral monologue.”⁶²

Morse’s approach assumed there was a single answer to every problem and consensus was always possible. But the C20 was a negotiation in which there were competing visions of what should drive the world economy towards equilibrium: tight adjustment (US) or tight asset settlement (Europe)? The two visions’ internally coherent logics were mutually exclusive. Some rules and procedures were common to both; many were not. An approach based on financial disciplines, for example, had no need for the US’ proposed new rules on graduated pressures, whereas an approach based on rapid adjustment had no role for European-style capital controls supporting fixed exchange rates.

Without C20 Ministers’ political guidance to Deputies, the competing visions of reform were allowed to run in parallel in the C20 discussions. Political decisions were needed at the outset to define the overarching structure and economic logic of the new international monetary order. C20 Ministers should have decided this before Deputies were asked to provide politically-acceptable solutions to Morse’s technical questions. Tackling political issues from a technical perspective wasted Deputies’ time and effort. Yet, after having held their initial (organisational) meeting in September 1972, C20 Ministers did not meet again until March 1973, and did not attempt to provide their Deputies with collective political guidance until late July 1973 - even then guidance was limited (Table 7.3).⁶³

⁶¹ Opportunities for genuine dialogue were further limited because the EEC and the G24 (the collective term for the developing country participants in the C20), respectively, prepared their unified positions in pre-C20 meeting sessions. These positions were inflexible during the course of a C20 meeting, making it almost impossible for Morse to reach consensus through a “give-and-take” negotiation.

⁶² Oort’s comment at a dinner held to mark the conclusion of the C20 negotiations.

⁶³ An early opportunity was lost in September 1972. Shultz set out the US plan for international monetary reform at the IMF Annual Meeting in September 1972, but it was not discussed at that time by C20 Ministers, who confined themselves to taking decisions on

Table 7.3 C20 meetings held between IMF Annual Meetings in 1972-73		
<i>Date</i>	<i>Level</i>	<i>Main issues discussed</i>
25-29 September 1972	Ministers and Deputies	Organisational
27-29 November 1972	Deputies	Adjustment, payments; Volcker tables US reform proposals too late to be discussed
23-25 January 1973	Deputies	US proposals on reform; adjustment indicators
22-23 March 1973	Deputies	Capital controls; LDC issues
26-27 March 1973	Ministers	Exchange rates; need for more rapid progress on reform
21-25 May 1973	Deputies	SDR/aid link; adjustment indicators; Bureau tables its first preliminary draft <i>Outline of Reform</i>
11-13 July 1973	Deputies	Adjustment and graduated pressures; list of six key questions for Ministers prepared; draft <i>Outline of Reform</i>
30-31 July 1973	Ministers	Adjustment indicators; graduated pressures, convertibility; SDR and gold valuation; SDR/aid link; preparation of draft <i>Outline of Reform</i> for Nairobi
5-7 September 1973	Deputies	Adjustment indicators; payments and convertibility; SDR issues, gold; draft first <i>Outline of Reform</i>
24-28 September 1973 (IMF Annual Meeting, Nairobi)	Ministers	Draft <i>Outline of Reform</i> ; set deadline for completing C20's work

organisational issues. In the absence of a further C20 Ministerial meeting in autumn 1972, Volcker was obliged to table the US plan at the C20 Deputies' first substantive meeting in November 1972. This was the wrong forum. Acceptance or rejection of the US plan was a political, not technical, decision. Taking such decisions was the responsibility of C20 Ministers, not their Deputies. Morse's Bureau added to the early sense of incoherence by simply picking apart the US plan and tabling its various elements individually for technical discussion.

Morse was left to make reform's building bricks, but had no agreed plan as to how he should assemble them. C20 Deputies came to every meeting with unreconciled national versions of the new international monetary order in their minds. They approached every individual issue from the perspective of how a solution might fit into their own overarching vision of the eventual order, and sought decisions that were consistent with their version of the new order (and only their version). Lack of momentum was inevitable.

Morse's bottom-up, issue-by-issue approach to reform compounded the delays caused by the lack of a unified vision of a reformed order. Decisions on many issues were inevitably conditional on decisions taken on other issues. Negotiators tackling one issue could not finalise their decision until they knew the outcome of decisions on related issues. So most "agreements" reached by C20 Deputies were in fact conditional. The US' standard approach to negotiations – "nothing is agreed until everything is agreed" – accommodates this on-going uncertainty during a complex negotiation. But Morse's issue-by-issue approach struggled with the complexity. Differences of view festered; arguments persisted without resolution. Deputies' frustrations mounted as they attended meetings in which they simply rehearsed their differences. Morse's approach resolved little during September 1972-April 1973.

Scholars were critical of the Bureau's performance and Finance Ministers were even more so.⁶⁴ They had lost patience with Morse by Spring 1973. He showed no signs of delivering a substantive draft reform for discussion at the IMF's Annual Meeting in Nairobi in September 1973. They could not understand why the first six months of the negotiations had been wasted on re-examining detailed issues covered thoroughly in the IMF's *Reform Report*.⁶⁵

⁶⁴ See De Vries, "Non-reform of the international monetary system", 585, and Williamson, *Failure of world monetary reform*, 70.

⁶⁵ The C20's lack of progress created a widespread sense of frustration. Claude Pierre-Brossolette, Director of the Trésor, regularly participated in C20 Deputies meetings. Exasperated, he told his colleagues in an OECD WP3 meeting the "(C20) consultation was endless" (WP3 meeting reported in a minute by Derek Mitchell to Geoffrey Littler, 26 February 1973; Bank of England archive file OV53/69). Others agreed. Mitchell met the Governor of the Bank of England, Leslie O'Brien, and his Deputy two days later in an effort to enlist their help in encouraging Morse to speed up. O'Brien attempted to defend one of his own staff: "The Governor ... recognised a growing feeling that they (the C20 Deputies' discussions) were not moving far or fast enough; however, it was not for want of trying." Mitchell was having none of it and told the Governor neither Morse nor his Bureau staff was good enough; he wanted to reinforce them from the Treasury (Note of meeting of the Governor, Deputy Governor and Derek Mitchell, HM Treasury on 28 February 1973; Bank of England archive file OV53/69). Japan was

The two most senior British officials participating in the C20 Deputies meetings, Derek Mitchell (HM Treasury) and Kit McMahon (Bank of England) met Morse on 17 February 1973. Mitchell warned him “the Americans feel insufficient progress is being made (in the C20 Deputies)”. Mitchell asked Morse to arrange additional C20 Deputies meetings, plus an early C20 Ministerial. Morse’s resisted, complaining that if Finance Ministers were hoping for results from the C20 Deputies meetings in time for the IMF Annual Meeting in Nairobi, their expectations were “inflated”.⁶⁶

Shultz called on Chancellor Barber shortly after the G10 had floated their currencies on 16 March 1973. Barber told him “international monetary reform was moving too slowly; finance ministers needed to decide the hard issues.” Shultz agreed, putting his finger on the main problem: “the C20 Deputies had worked on semi-technical issues: they needed political guidance.”⁶⁷

Foreign exchange markets’ destruction of Volcker’s February 1973 exchange rate realignment and the “temporary” move to generalised floating exchange rates in March created a sense of crisis that accelerated the C20 negotiations. C20 Deputies met in Washington on 22 March 1973, where they agreed to pursue Morse’s agenda with “added urgency”.⁶⁸ Unsurprisingly in the light of the Eurodollar market’s role in undermining Volcker’s carefully calibrated dollar devaluation, Deputies agreed to prioritise work on capital movements and “consolidation of reserves”.⁶⁹ Intriguingly, Deputies also initiated a philosophical discussion about the meaning of “stability”. It appeared of little relevance at the time, but was later used to help justify the C20’s decision to continue generalised floating in 1974.⁷⁰ Two concepts of stability were proposed:

worried by the C20’s lack of progress. HM Treasury’s record of the G10 meeting that adopted generalised floating shows the Japanese alarm at generalised floating. Finance Minister Aichi “made a strong plea for a return to a fixed parity system” because, in his view, floating risked creating competitive devaluations and trade restrictions.” Aichi warned “if the system was thrown to the mercy of market forces, there would be chaos.” He urged the G10 to “expedite” the C20’s work (HM Treasury’s confidential Note for the Record of the 16 March 1973 G10 meeting, produced by Roger Lavelle, 19 March 1973; Bank of England archive file OV53/70).

⁶⁶ Mitchell reported the meeting in his minute to Geoffrey Littler (HM Treasury), 17 February 1973 (Bank of England archive file OV53/69).

⁶⁷ HM Treasury record of the meeting between the Chancellor and US Treasury Secretary Shultz, 19 March 1973 (Bank of England archive file OV53/70)

⁶⁸ Reported in a telegram from the British embassy, Washington, to London, telno 208 of 22 March 1973 (Bank of England archive file OV53/70)

⁶⁹ Consolidation involved converting surplus dollars in official reserves into other reserve assets.

⁷⁰ Scholars, including Guzzini, in *Realism*, Kunz, *Butter and guns*, Sterling-Folker, *Theories of international co-operation*, and Strange, *Casino capitalism*, who argued the US

exchange rate stability (believed by many to be essential to create certainty for economic actors); and, stability of the system and structures that generate exchange rates (some argued fixed exchange rates no longer created certainty because the Eurodollar market could defeat central banks' attempts to defend any fixed exchange rate). The Deputies' debate marked the point at which some minds began to change, albeit not in the US delegation.⁷¹ The majority of C20 participants continued to favour pursuing exchange rate stability, but attitudes shifted over time: the minority view became the majority after OPEC raised oil prices in autumn 1973.⁷²

C20 Ministers held their first substantive meeting in Washington on 26-27 March, a week after their Deputies had met.⁷³ Bruised by their recent experiences, Ministers were determined to achieve two objectives: to confirm the new international monetary order would be based on fixed exchange rates; and to accelerate progress on reform. They achieved both objectives.

The C20 Ministers' official communiqué reaffirmed their intention to base the new order on "stable but adjustable par values".⁷⁴ This followed their

changed its mind about what it wanted from monetary reform could, with some justification, have pointed to this meeting and the attempt to redefine "stability" as systemic stability in place of exchange rate stability as the point at which the ideological worm began to turn. In fact none of them did so. But perhaps they should have done to strengthen their case!

⁷¹ HM Treasury's leading official on the C20 negotiations, Derek Mitchell, was beginning to change his opinion. Mitchell prepared a brief for Chancellor Barber for the C20 Ministerial meeting in Washington on 26-27 March in which he stated the UK's leading objective was to establish "a stable system of fixed but adjustable parities". However, Mitchell's so-called supporting arguments told a rather different story. Mitchell observed "present events" (i.e. the Volcker devaluation's failure and the G10's subsequent adoption of generalised floating) had cast doubts on the viability of stable but adjustable exchange rates. "As the old rules of conduct relax, the *fait accompli* must be recognised. The question then becomes: to what extent must protracted periods of floating come under surveillance of the IMF?" Mitchell drove home the point: "Floating has been adopted more widely because of the inadequacy of capital controls. Indeed, it has proved itself the best defence against speculative capital movements. A return to fixed but adjustable rates is not possible until capital flows can be controlled." A Treasury Minister of State (not named) scribbled his comments to the Chancellor on his personal copy of the brief: "How can fixed exchange rates be resumed without capital controls and how can capital controls be imposed without foreign exchange controls inimical to the UK's trade in invisibles (as well as goods)?... My own feeling is that a continued regime of floating rates is in the UK's best interests and the trading interests of all western developed nations." (see D. J. Mitchell Note for the Chancellor, 20 March 1973; Bank of England archive file OV53/70)

⁷² Bank of England's Note for the Record (produced 27 March 1973) of the C20 Deputies meeting, Washington, 22-23 March 1973 (Bank of England archive OV53/70)

⁷³ The Deputies meeting had been delayed 10 days by the need to attend to the crisis in foreign exchange markets in February, and its resolution through the decision to adopt generalised floating on 16 March.

⁷⁴ Williamson, Failure of world monetary reform, 70. The communiqué also mentioned floating "... in the reformed system the exchange rate should remain based on stable but adjustable par values. It was also recognised that floating could provide a useful technique in particular situations." (Quoted in Solomon, International monetary system, 248)

discussion in which Shultz stated fixed but adjustable exchange rates should be the new order's "centre of gravity", qualified by his caveat "there should also be room for floating".⁷⁵ Shultz had earlier clarified his views on floating in his meeting with Barber in London, saying floating should be no more than "temporary" and "the (US) reform proposals should set out clear rules for floating and relate these to the rules for the flexible par value system".⁷⁶ Schultz's clarification had dispelled the uncertainty over the US position on floating some US officials had been attempting to create.⁷⁷ It was clear to C20 Ministers the US was determined to build a durable "fixed but adjustable" exchange rate order in which floating would be a temporary safety valve to relieve foreign exchange market pressures, not a way of life.

Morse reported the C20 Deputies' work to C20 Ministers; they told him the slow progress was unsatisfactory.⁷⁸ Ministers urged Morse to be more efficient and commissioned two studies: the US proposals for "objective indicators" of adjustment; and, "destabilising capital flows". To avoid putting the

⁷⁵ FCO report of the C20 Ministers meeting, telegram 213 of 26 March 1973 from British embassy Washington to London (Bank of England archive file OV53/70)

⁷⁶ Shultz and Barber met in London on 19 March 1973 (Bank of England archive file OV53/70).

⁷⁷ Derek Mitchell, HM Treasury, met Peter Flanigan, Executive Director of the Council on International Economic Policy (1972-74) and Assistant to the President for International Economic Affairs (1969-74), in Washington on 11 July 1972. According to Mitchell's Note for file, Flanigan told him the US should demonstrate international leadership on monetary reform, but he was not sure what direction it should take; his Wall Street experience predisposed him to adopt market-driven solutions and he thus believed the new order should be based on "a universal regime of floating" (Bank of England archive file OV53/43). Flanigan was consistent in advocating a floating exchange rate system during 1972-74, notwithstanding the Nixon administration's official commitment to the Shultz/Volcker reform plan. Flanigan returned to the theme in a conversation with A. K. Rawlinson, British embassy, on 22 March 1973. In a Note for file dated 22 March 1973, Rawlinson recorded "On substance, his (Flanigan's) main theme was to advocate permanent floating, at least for the US dollar" (Bank of England archive file OV53/70). Jack Bennett, the Deputy Under Secretary of the Treasury for Monetary Affairs (i.e. Volcker's assistant), was another consistent advocate of floating, although, unlike Flanigan, he attempted to disguise his differences with official US policy at times. For example, it was already clear the Volcker devaluation of February 1973 was failing when the OECD's WP3 committee met on 26 February 1973. Bennett, representing the US, was pressed by European participants on the basic question: did the US believe in continuing with fixed but adjustable parities, or was it content for all states to adopt floating? Kit McMahon, the Bank of England's representative in the WP3 meeting, recorded "Bennett half-ducked the question, saying four of the US' six major trading partners were floating; if others wished to float, the US would be content" (McMahon's secret minute to The Governors on "International Monetary Reform After the Recent Upheavals", 28 February 1973; Bank of England archive file OV53/69). The impression Bennett sought to create of the US favouring floating was at odds with the US' official position at the time, a position that did not begin to shift until Nixon, Kissinger and Shultz had discussed matters in early March (see chapter 6).

⁷⁸ FCO report of the C20 Ministers meeting, telegram 213 of 26 March 1973 from British embassy Washington to London (Bank of England archive file OV53/70)

issues into the over-scale C20 Deputies meeting format, Ministers insisted both studies should be undertaken by new, streamlined, “technical groups”.

Optimism Grows, May–September 1973

When C20 Deputies convened their fifth meeting, held in Washington on 21-25 May 1973, Morse appeared to have taken the C20 Ministers’ message to heart, telling participants this was “the start of the negotiating phase”. Their first day was devoted to developing countries’ issues, the following three days were spent on specialist topics.⁷⁹ Despite the new sense of urgency and an emerging awareness that some states’ initial negotiating positions were not set in stone, no breakthrough was achieved. The British assessment of the meeting made for sad reading: there had been “little clear evidence of progress”.⁸⁰ Morse, instead of driving the negotiation forward, had reverted to his habit of focussing discussion “on clarifying each and every difference of opinion to provide a starting point for future negotiations.” Agreement was limited to the need for further technical work.⁸¹

This was a poor return from Deputies’ efforts, yet a logjam had been broken. The stated purpose of meetings had shifted from the technical to the political. The advent of negotiations meant that power now mattered more in the discussions than technical economic proficiency. The Nixon-Pompidou summit in Reykjavik (31 May – 1 June) reinforced the sense that the real bargaining had begun and threw into sharp relief the question of what states were bargaining about, and who would be the main protagonists. Despite Morse’s earlier emphasis on their differences, C20 Deputies began to believe compromises would be struck and problems solved in time for Nairobi.

The C20 Ministers meeting in March had made told Morse to lay the basis for an early C20 Ministerial agreement on reform’s principles, and

⁷⁹ These comprised: adjustment and indicators; capital flows; methods of intervention; asset settlement; reserve diversification or consolidation; the SDR’s role and its development; SDR valuation and interest rates; and, gold and the system numéraire (British embassy Washington telno 279 of 21 May 1973; Bank of England archive file OV53/71).

⁸⁰ British embassy Washington telegram to London, telno 283 of 25 May 1973 (Bank of England archive file OV53/71). See also A. L. Coleby’s “Record of C20 Deputies Meeting, 21-25 May 1973”, the Bank of England’s official record (Bank of England archive file OV53/72).

⁸¹ On the SDR/aid link, SDR valuation methodologies and multicurrency intervention

produce a draft outline agreement on reform for discussion at the IMF Annual Meeting in Nairobi in late September. C20 Deputies were capable of examining the individual measures necessary to support a compromise blend of the competing versions of reform (i.e. combining the US' tight adjustment with Europe's tight asset settlement) to form a workable package. But if there were to be a realistic prospect of agreement in Nairobi, further C20 discussions would have to be held at the political, not technical, level. A C20 Ministers meeting would be required, yet no follow-up to March's meeting had been scheduled.

Rawlinson (British embassy, Washington) reported to London his conversation with Volcker which neatly illustrated neoclassical realism theory's prediction that members of the Foreign Economic Policy Executive would mediate between international and domestic political pressures as they set foreign economic policy. Volcker told Rawlinson he proposed to pursue US policy on international monetary reform in a manner that would respect both international and domestic political constraints and imperatives. Volcker said a C20 Ministerial was needed on 30-31 July as well as a prior C20 Deputies meeting in Washington in July. Rawlinson interpreted this as evidence the US was serious about achieving an outline agreement on reform at Nairobi, and reported Volcker was becoming increasingly confident of a successful outcome: "It seems to us that elements of a bargain were emerging. The Americans had gone a long way towards getting effective acceptance of the essential elements of their position on adjustment. In return, it ought to be possible for them to co-operate in agreeing something, at least in principle, on convertibility, asset settlement and consolidation. Volcker seemed receptive to this."⁸²

Volcker made it clear the US would not seek a deal at any cost and, for the UK's (and EEC states') benefit, he insisted on clarifying limits to what the US could accept in the C20 bargaining process. Rawlinson reported Volcker as having two particular concerns. First, he feared a loose or "sloppy" adjustment process being accepted in return for a "rigid" (i.e. tight) process on convertibility and asset settlement. This, Volcker argued, would pose a political problem for the US because Congress would be expecting a "consistent and balanced" bargain. In an earlier, separate meeting with John Kirbyshire (Bank of England)

⁸² A. K. Rawlinson, British embassy, Washington, note for file, 14 June 1973 (UK National Archives file T354/385).

in May, Volcker had said he wanted a July C20 Ministerial meeting to focus on “the extent of rigidity versus flexibility in the rules of the new system”.⁸³ This was the “rules versus discretion” issue in all but name. The US wanted to make the call on where the new order would have rules (on adjustment) and where discretion would apply (on asset settlement). Volcker was simply attempting to assert a US hegemon’s rights to define its bottom line and demand what Washington believed would be appropriate co-operation and consensual compliance from other states.

Volcker also had to manage the domestic politics of international monetary reform. His second negotiating limit was defined by his well-founded belief the US would be a debtor in a new SDR-based order. The US would inevitably incur large SDR debts because, under both his plan and the Europeans’ preferred approach, the US would convert some or all of the outstanding dollar balances held in foreign central banks’ reserves to SDRs through a new “Substitution Account” at the IMF.⁸⁴ The US did not possess enough SDRs to repurchase the dollars held by foreign central banks and would need to borrow a special issue of SDRs from the IMF to buy them. Even if (under his plan) Volcker could persuade other states to hold large volumes of dollars in their reserves as “working balances”, the US would nonetheless be a substantial SDR debtor. Volcker therefore wanted to prevent the C20 setting higher interest rates on SDR-denominated liabilities than the US currently paid on its dollar liabilities, which would impose new fiscal costs on SDR debtors, including the US. If SDR liabilities were more expensive than dollar liabilities, the US Treasury would have to seek Congressional approval for a new fiscal appropriation to cover their cost.

Volcker wanted to avoid incurring additional costs and going to Congress for an additional appropriation to pay them. He therefore warned Rawlinson explicitly “Congress would not accept a system that imposed higher costs on the US than the current cost of foreigners holding dollars”.⁸⁵ If US administrations do not wish to do something another state requests, they often tell the other state Congress is to blame for blocking progress, even when this is

⁸³ J. A. Kirbyshire’s record of his conversation with Volcker, 25 May 1973 Bank of England archive file OV53/71)

⁸⁴ Also described as “substitute” or “consolidate” during the negotiations.

⁸⁵ A. K. Rawlinson, British embassy, Washington, note for file, 14 June 1973 (UK National Archives file T354/385).

not the case. It is a well-worn tactic. However, Volcker was not bluffing in this instance. Watergate was by then damaging the Nixon administration's reputation, jeopardising its ability to get its business through Congress. Accepting new fiscal costs for the US as a result of international monetary reform would complicate the administration's already difficult task of obtaining Congressional approval for reform; Volcker wanted to avoid it.

Notwithstanding Volcker's reservations, a deal was in the making whereby the US would get most of what it wanted on adjustment and Europe get most of what it wanted on asset settlement. This was the big political decision Finance Ministers needed to take at their July C20 Ministerial. Morse could then capture their tentative agreement in his *Outline of Reform* document, and submit it to IMF member states for approval at their Annual Meeting in Nairobi. (Ahead of the game for once, Morse even had a draft document ready and tabled it at the C20 Deputies and Ministers meetings in July.) Once the *Outline of Reform* had been formally agreed at Nairobi, the C20 Deputies could sort out the many consequential technical details over the following 12 months, some of which would flow naturally from the political decision on the new order's structure. The final version of the new international monetary order would then be ready to adopt and activate at the IMF's Annual Meeting in 1974.

Shultz Drives Towards Reform

In June Shultz decided time was ripe for an international agreement on reform. He wanted an order based on fixed but adjustable exchange rates underpinned by new adjustment responsibilities for surplus states. Concessions on convertibility - which Shultz believed would be in the US' interests - and asset settlement ought to be enough to win European and Japanese support. Notwithstanding his Friedmanite ideology, Shultz pragmatically accepted the new order would include a restrictive approach to floating exchange rates. The US reform plan envisaged floating would be permitted as a temporary measure in "particular circumstances" or, for states wishing to float for longer, it would be permitted only in the unlikely event they would foreswear trade protectionism and all capital controls. Even Canada,

floating's staunchest advocate, would balk at those conditions. Volcker had planned this order; Shultz had proposed it at the IMF; and both had worked hard for it since September 1972, defending it within the Nixon administration and promoting it abroad.⁸⁶ There was no evidence in June 1973 of the prevarication or ambivalence towards reform in the Foreign Economic Policy Executive that some scholars, including Gowan and Strange, subsequently claimed to detect.⁸⁷ On the contrary. Shultz pressed for reform and took initiatives to guard against reform being derailed by domestic political opposition. He and Volcker actively prepared Congress, US business and the American public for an agreement on the new, fixed exchange rate-based international monetary order.

Volcker and Burns were invited to provide testimony on international monetary reform to Congress' Joint Economic Committee in late June.⁸⁸ Both made clear the US' objective was to create a new order based on "stable but adjustable par values" with some provision for floating. And both argued the "present (floating) arrangements were not a substitute for real, long-range reform". Volcker was keen to share his optimism about the prospects for an early C20 agreement: his testimony predicted there was "a very reasonable chance" of reform's principles being agreed at Nairobi.

The C20 Deputies meeting in Washington on 11-13 July appeared to justify his optimism, although there were also warning signs of US and

⁸⁶ See, for example, the transcript of the White House tape in which Shultz insists it is in the administration's and US' interest to adhere to Volcker's Plan X in the face of Nixon's and Kissinger's expressed scepticism. Shultz's advocacy of a return to gold convertibility was especially noteworthy: "I think that convertibility is something that is important to have in a monetary system. If the system is so constructed that it has the kind of equilibrium that makes convertibility unnecessary, it is sort of applying a psychological edge to something that doesn't need it. Where you don't need it, you can have it. Where you need it, in a sense that people want to convert, as now, you can't have it, because we don't have that much (gold) to convert with... The French say they don't believe in an equilibrium system, because the elements of equilibrium not only include trade, but they include our military operations, they include our aid operations, and they include our investment. And they don't agree that, somehow or other, the exchange system should give us a hand to play in those three fields." (Transcript of White House Tapes, conversation 868: Conversation Among President Nixon, the President's Advisor for National Security Affairs, Kissinger, and the Secretary of the Treasury, Shultz; 3 March 1973; Rasmussen, Foreign economic policy, 87)

⁸⁷ See Gowan, Global gamble, and Strange, Casino capitalism

⁸⁸ British embassy, Washington telegram of 28 June 1973 reports Burns' and Volcker's testimony to Congress' Joint Economic Committee on 26-27 June 1973 (UK National Archives file T354/385). In his testimony Burns - a consistent advocate of fixed exchange rates - told Congress of the dangers of continuing with floating exchange rates. He felt governments would be unable to resist the temptation to intervene to manipulate their exchange rate for mercantilist purposes, creating political frictions and economic uncertainties.

developing country unwillingness to compromise. According to the Bank of England's record, Morse had circulated papers to Deputies setting out options and seeking compromises.⁸⁹ The initial signs were encouraging. The Bank of England's representative noted "At the outset it was apparent that ... the move toward compromise was receiving a constructive response. No speaker seriously resisted the diluting of any extreme position he had previously taken and many others began actively to look for further compromises... Little gap remained on the text on adjustment." But there was no further sign of progress on the second day, with the US digging in to oppose both competitive SDR interest rates and, with FRG support, the SDR/aid link. The latter was risky because it was the developing countries' main objective. The Bank's record also noted "speakers reverted to extreme positions on gold". The meeting deteriorated further on its third day. Morse seized the initiative and read out his proposed compromises, hoping to elicit more. According to the Bank of England's record, "He was disappointed. What he got was a prepared statement on behalf of the G24... and an extremely destructive intervention by Volcker. Volcker later sought to moderate the gloom caused by his intervention, but its effect was to abort any response there may have been to the suggested paths to compromise".

A belatedly-arranged C20 Ministerial meeting on 30-31 July also made little substantive progress, yet left open the possibility of a consensus before Nairobi.⁹⁰ A French proposal aimed at strengthening graduated pressures appeared significant because it implied France had at last accepted the need for symmetry in surplus and deficit states' adjustment responsibilities.

Volcker held a cheery press conference at the Ministerial meeting's conclusion. He told the media that while ministers had not produced the results

⁸⁹ A. L. Coleby's, Overseas Office, Bank of England, record of the C20 Deputies meeting, Washington, 11-13 July 1973 (Bank of England archive file OV53/72).

⁹⁰ Solomon records C20 Ministers were asked to take decisions on six political issues. The US found itself in a minority in all of them. This prompted his observation that "everybody wants reform, but no one wants change" (Solomon, International monetary system, 254-55). FCO records of the C20 Ministerial reported Shultz as "isolated" on the first day and in a minority on the second day (British Embassy Washington telno 373 of 30 July 1973 and telno 381 of 31 July 1973, both held in Bank of England archive file OV53/72). A. L. Coleby's Bank of England record of the C20 Ministerial was even less encouraging, observing there had been "no measurable progress" largely because "Ministers were not yet ready to begin political bargaining," although the US "appeared to give ground to the EEC on adjustment indicators" by accepting these would merely trigger assessments of the need for adjustment, not adjustment measures themselves (Bank of England archive file OV53/73).

he and Shultz had hoped for, they had nonetheless generated optimism that an early agreement was possible and floating would end. US politicians, business, finance and the public could now see the C20 negotiations were making progress, although much remained to be agreed. The French proposal indicated the C20 was closing in on a consensus on the half of the grand bargain the US had prioritised: stronger adjustment arrangements. The half of the grand bargain Europe wanted - new, stricter, asset settlement arrangements - remained to be agreed. Developing countries still needed something on resource transfers and IMF governance to bring them on board. Once they were, an outline of the new international monetary order would be ready for Finance Ministers to approve at Nairobi.

Volcker, although justifiably optimistic did not wish to give the impression these remaining negotiations would be plain sailing. He warned in his 31 July press conference that identifying solutions "...seems easier probably in some areas than in other areas where certain differences remain". He cited SDR valuation and remuneration, and the SDR/aid link as examples of divisive issues. Significantly these were areas in which the US would be required to compromise and accept additional resource costs to achieve consensus. Nonetheless, Volcker predicted "a basic agreement" would be "hammered out" at Nairobi after an "intensive period of negotiation"; he indicated the US was ready to compromise and dismissed the possibility of continuing the "transitional regime of floating" for much longer.⁹¹

Building on Volcker's efforts to inform the US public and Congress of the likely outcome of a C20 agreement, Shultz initiated politically significant supporting measures in August 1973. Determined to bring US finance, business and the American population up to speed on the C20 negotiations, he announced he was forming a 14-strong "Advisory Committee on the Reform of

⁹¹ Volcker told the 31 July press conference "... there is, I think, not only a desire to get ahead (in the C20), but a feeling of some confidence that the desire can materialise into a workable system... There was a feeling - the general mind - that solutions on various points can be found." He dismissed floating "... while (floating) is appropriate for this situation, this is not monetary reform. This is not what you would want to see in the long run. There is a need for rules and of a system and a kind of predictability of reaction and a known sense of what the rules are... the sense of absence of rules I think quite correctly bothers people. (Floating) relies too much on ad hoc decisions and ad hoc judgements and the sense of that has, I think, become the story" (The verbatim text of Volcker's opening statement to the 31 July 1973 press conference and the subsequent questions and answers session are held in the HM Treasury file T354/385 in the UK National Archives).

the International Monetary System” on 22 August.⁹² Its purpose was to act as a “sounding board” and to help the administration “win over influential private financial opinion”. It included himself and three former Treasury Secretaries (Connally, Fowler and Dillon), five CEOs of large Wall Street banks and five leading businessmen. Within days he also announced he would publish a compilation of papers on international monetary reform.⁹³ These included the outline of US objectives, statements of official views on reform issues and two papers previously submitted to the C20.

Shultz’s domestic initiatives underscored his determination to remove any domestic political obstacles to reform. As neoclassical realists might have predicted, Shultz, Volcker and Burns were striving in the C20 to ensure international monetary reform proposals satisfied US interests in the international sphere, and were working energetically domestically to ensure reform would be politically acceptable to Congress, Wall Street, US business and the American population. There was no doubting Shultz’s intention to push through an outline agreement on reform at the IMF Annual Meeting in Nairobi, leaving only technical details to be worked out over the following year. Meanwhile he aimed to shape domestic opinion, neutralising any opposition to the concessions he expected to have to make in the C20. His initiatives went beyond the role neoclassical realists expected the Foreign Economic Policy Executive to play: rather than passively accepting domestic political pressures and mediating them into the US response to international political imperatives (as neoclassical realism theory predicts), Shultz aimed to shape the previously disinterested US domestic opinion to ensure it dovetailed with his approach to reform in the C20.⁹⁴

⁹² British embassy Washington telegram to London of 24 August 1973 (see HM Treasury file T354/385 in the UK National Archives)

⁹³ British embassy Washington telegram to London of 27 August 1973 (see HM Treasury file T354/385 in the UK National Archives)

⁹⁴ Nixon believed his administration was largely free from domestic political constraints on international monetary relations because few people understood or were interested in the subject. Discussing international monetary affairs with Shultz and Burns in February 1973, Nixon observed: “Well, the number of people who understand it is small... The average person does not know a damn thing about this: it is the stock market people and the international monetary people... (So) there are no political problems involved.” (Conversation Among President Nixon, Treasury Secretary Shultz and Chairman of the Federal Reserve system Board of Governors, Burns; White House Tapes conversation 851-4, 6 February 1973; Rasmussen. Foreign economic policy, 4-21). Nixon returned to this theme in March when discussing international monetary relations with Kissinger and Shultz, saying “I think except for a few New York bankers and a few others, most people don’t understand international

Shultz's problem was that nothing similar happened in Europe. France in particular had decided it was prudent to play matters long and was in no hurry to compromise, nor was the French government preparing its population for necessary and inevitable C20 compromises.

France was the polar opposite of the US on international monetary reform. It hoped to capitalise on what appeared to be a weakening in US economic power over the international monetary order by writing new rules in the C20 that would permanently constrain US hegemony.

Giscard d'Estaing had said from the outset that a return to dollar/gold convertibility would be "the touchstone of reform".⁹⁵ Paris' view of a new international monetary order was essentially a return to the Bretton Woods regime agreed in 1944, with the addition of tougher disciplines on convertibility and measures to tackle the dollar overhang in central banks' reserves. This, Paris hoped, would increase French gold reserves. It would also oblige the US to sell its limited reserve assets to fund its future deficits, curtail the dollar's privileges and thus undermine the US' ability to project its power onto the French and European economies. If France were successful in the C20, it - and the EEC - would achieve gains in economic power relative to the US by securing a new order based on strict asset settlement rules and a discretionary approach to adjustment, the very opposite of what the Shultz wanted.

(monetary) things and couldn't care less." Nixon cited as evidence Arthur Burns' recent failed effort to identify domestic political support for his preferred international monetary policy. Nixon observed "I think that was what Arthur was admitting, to his chagrin. He found as he called around the country people weren't all that stirred up about it." Shultz questioned Nixon's judgement on the matter, arguing people might not understand international monetary affairs but they were concerned when they saw the dollar under attack. Nixon reassured him "Let's leave that out. We can handle that. What I am thinking about is the, the use of a more positive leadership role (in international monetary affairs)..." (Conversation Among President Nixon, the President's Advisor for National Security Affairs, Kissinger and Treasury Secretary, Shultz; White House Tapes conversation 868-15; 3 March 1973; Rasmussen, Foreign economic policy, 72-91). Shultz's decision to form what was in effect a committee of private sector "Wise Men" ostensibly to advise him, but mainly to inform the US public on international monetary reform, as well as his decision to publish the key international monetary policy papers the public needed to access to form a view on US interests were part of Shultz's effort to "handle" US public attitudes by informing and educating it. Gowa, in "Public goods and political institutions", argues there are few lobby groups active in the US on international monetary policy largely because, outside Wall Street, the issue is regarded as a public good. Dam, in *Rules of the global game*, concurs.

⁹⁵ Comment in Giscard's speech to the IMF Annual Meeting, September 1972 (quoted in Solomon, International monetary system, 239).

The French believed international monetary discipline required the new order to be built on fixed but adjustable exchange rates, with no privileges for the dollar. In Paris' view, Washington's ruthless exploitation of the dollar's privileged position had wrecked Bretton Woods. In the French version of a new international monetary order the US would be forced to repurchase dollars held by other states' central banks using gold or SDRs ("primary reserves"). US primary reserves were insufficient so, according to France, the IMF should manage the dollar conversion process. It would lend the US the SDRs needed to repurchase dollars from central banks abroad through a new "Substitution Account", and charge the US a competitive interest rate on its SDR debts. The SDR would be a "hard" currency, maintaining its value against G10 currencies: the US would be unable to inflate away its SDR debt burden. Were the US to run balance of payments deficits in future, it would be mandatory for it to repurchase the dollars taken in by foreign central banks with gold or SDRs, i.e. a full restoration of dollar convertibility. France intended these rules to be symmetrical: they would apply to any state running balance of payments deficits and to any state whose national currency had accumulated in other central banks' reserves, notably the UK's sterling balances. A proper respect for gold and its paper equivalent, the "hard" SDR, would bring the Anglo-Saxons to heel!

Initially France did not want adjustment pressures to be applied to states running balance of payment surpluses. It argued strict asset settlement rules would stimulate rapid adoption of deflationary policies in deficit states, thereby limiting current account imbalances. The French believed capital controls should be mandatory to restrict capital outflows from deficit states and to help protect fixed exchange rates from foreign exchange market pressures. If the C20 outcome did not include mandatory capital controls, the IMF should be given the right to impose them on states as part of an IMF-financed adjustment programme.⁹⁶ (This was the French equivalent of Volcker's proposed graduated pressures.) In French eyes, currency revaluation or devaluation would be a last resort: prior IMF approval would always be required.⁹⁷

⁹⁶ France had pushed hard for this at the C20 Deputies meeting a few days before the Reykjavik Summit (A. L. Coleby's Bank of England record of the C20 Deputies meeting, 21-25 May 1973; Bank of England archive OV53/71).

⁹⁷ The French perspective is set out in The FCO's guidance telegram (No. 148), classified restricted, on the International Monetary Situation, sent to all posts on 7 June 1972 (Bank of England archive file OV53/43).

Unlike the US, France had no wish to see gold phased out of international monetary arrangements. In Paris' view, gold's premier role as a reserve asset would be enhanced by raising its official price to the market price and giving central banks new rights to trade gold freely with the private sector. This would enable central banks to buy in gold from the private sector to increase their stocks of monetary gold.

This vision of the new international monetary order was totally at odds with the US view. The *Financial Times* commented at the outset of the C20 negotiations "the main opponents are still France and the US".⁹⁸ Schultz agreed, and understood why. He warned Nixon ahead of the Reykjavik Summit with Pompidou "French monetary objectives are in large part designed to undercut the ability of the United States to exert effective leadership in world affairs. The substantive French monetary position - more than that of any other country - is opposed to ours."⁹⁹ The enlarged EEC was happy to tuck in behind France on all but the most extreme elements of the French position. Italy was under balance of payments pressure and wanted to make greater use of its gold reserves. The UK, now a member of the EEC, wanted to prove its European credentials by not alienating France. The FRG, caught between valuing European integration and the US contribution to its security, did not want have to choose between its European and security priorities; it kept its head down, as did the smaller EEC states. The C20 negotiations therefore became, in effect, a re-run of the Connally v Giscard d'Estaing stand-off that had preceded the Smithsonian Agreement.

With the exception of two concessions, President Pompidou and Finance Minister Giscard d'Estaing obdurately defended this French vision of the new international monetary order in the period between the IMF Annual Meetings in 1972 and 1973. The concessions – France accepting the SDR as the new monetary order's numéraire and Volcker's proposed graduated pressures - seemed helpful to the US, but this was deceptive: both concessions were less than they appeared.¹⁰⁰ Moreover, while offering France's second concession,

⁹⁸ The *Financial Times*, 7 September 1972 (see UK National Archives file T354/285).

⁹⁹ *Monetary Discussion with President Pompidou*, not classified Memorandum from Treasury Secretary Schultz to President Nixon, for inclusion in the President's Briefing Book for the Reykjavik Summit, 31 May – 1 June 1973 (Rasmussen, Foreign economic policy, 138-45)

¹⁰⁰ The first did not arrive until the G10 had moved to generalised floating in March 1973. Although the G10 had declared floating to be "temporary", the episode shook confidence

Pompidou simultaneously attempted to undermine the US position by proposing the USSR should be admitted to IMF membership and be permitted to shape both the IMF's and the new international monetary order's rules.¹⁰¹

in fixed exchange rates. On 19 March, the Governor of the Bank of England, Leslie O'Brien, reported to Chancellor Barber that France had made a "significant concession" in the EEC Committee of (central bank) Governors: they had accepted the SDR as the new international monetary order's numéraire (letter from the Governor of the Bank of England to the Chancellor, covering the EEC Committee of Governors' report to the EEC Finance Ministers committee, 19 March 1973; Bank of England archive file OV53/70). This, however, was not quite all it seemed. Later that day Giscard d'Estaing appeared on television to reassure a French population shocked by the international monetary disorder and by the move to floating exchange rates. Giscard revealed a more nuanced version of the French concession, saying "In the future, the reference value (of a reformed international monetary order) could be a sort of SDR – a kind of abstract international bank note. But to start with it (the SDR) would need to link to something absolute". He meant gold. (See the verbatim record of Giscard's televised remarks on 19 March 1973, Bank of England archive file OV53/70) So France was accepting the SDR as numéraire, provided it became a proxy for gold in a fixed exchange rate system. Not much of a concession!

The second French concession was proposed by Claude Pierre-Brossolette at the Franco-US Summit in Reykjavik on 31 May – 1 June 1973. He told the US France was prepared to accept the principle of graduated pressures being applied to states running persistent balance of payments surpluses; France accepted graduated pressures could include a requirement for the surplus state's excessive reserves (not defined) to be placed in an account at the IMF, for which the IMF could levy a charge on the depositor state (i.e. a negative interest rate). Volcker regarded this as a helpful gesture because it implied France had accepted the US approach to symmetry and adjustment. Volcker observed: "Some hope was stirred when the French conceded there was some point to American concerns about the need for symmetry, and made a helpful gesture toward accepting a modified form of our indicators approach" (Volcker and Gyohten, *Changing fortunes*, 122). The French proposal to strengthen "graduated pressures" did indeed appear to signal France had accepted the principle that surplus as well as deficit states should adjust because the new "graduated pressures" were required only to discipline states running excessive balance of payments surpluses; states running deficits under the Bretton Woods regime had always been subject to the graduated pressure of losing their finite gold and foreign exchange reserves.

Again, however, the French concession was not quite what it appeared. At those same discussions in Reykjavik, Giscard d'Estaing firmly rejected the US proposal that the reserve-movement indicators *require* a state to adjust. Giscard would not go beyond regarding the indicators as signalling the need for states to *consider* taking adjustment measures (See the three US Memoranda of Conversation, variously classified Confidential or Top Secret, recording the two days of discussions; Rasmussen, *Foreign economic policy*, 146-69). In the French view, adjustment should remain a discretionary process, not rules-driven, and, moreover, it would remain purely the responsibility of states, not the IMF. When an incredulous Shultz pressed Giscard on how France proposed to oblige surplus states to adjust, Giscard admitted he had "no specific answer" to Shultz's question; Pierre-Brossolette reminded Shultz political pressures had been applied to Japan in 1971-73 to push Tokyo into accepting adjustment (Confidential Memorandum of Conversation, Shultz/Volcker/Giscard/Pierre-Brossolette, 31 May 1973; Rasmussen, *Foreign economic policy*, 146-57). The Gallic determination to maintain a discretionary approach to adjustment was what Shultz and Volcker had feared and expected.

¹⁰¹ When Kissinger formally launched the "Year of Europe" in a speech on 23 April 1973 he noted "We are in a period of relaxed (East-West) tensions. But as the rigid divisions of the past two decades diminish, new assertions of national identity and national rivalry emerge" (Kissinger, *Years of upheaval*, 152). Kissinger was particularly concerned détente created conditions in which Western alliance coherence would be sacrificed to the pursuit of national advantage in relations with the USSR (*Ibid.*, 194). Even so, the US side at Reykjavik was surprised by France advocating Soviet membership of the IMF. Pompidou, aiming to unsettle the Americans, astounded Nixon and Kissinger when he remarked: "I foresee that the Soviet Union will ask to join the IMF. Everyone will agree in the name of détente and the Soviets will come with a currency of fixed parity based on gold and convertibility. Consider the

It is not clear how serious Pompidou was about Soviet membership of the IMF. But his message to Washington was absolutely clear: agree a new international monetary order either now on terms acceptable to France, or later on terms acceptable to France and the USSR. In June 1973 France was prepared to play the C20 long and was in no hurry to compromise its interests for the sake of early agreement at Nairobi.

The British, having joined the EEC in 1973, were initially generally content to follow the French lead on EEC issues. As a major trading nation and global financial centre, however, the UK wanted early resolution of the international monetary problems. London therefore tried in Brussels to chivvy France into agreeing to settle the C20 issues at Nairobi. In June 1973 the UK

consequences.” (Top Secret Memorandum of Conversation, Nixon/Kissinger/Pompidou, 31 May 1973; Rasmussen, Foreign economic policy, 158-65) This was news to the US and a threat to US objectives. Kissinger, already aware the USSR was wedge-building through a policy of “differential détente” towards NATO members, was taken aback (Kissinger, Years of upheaval, 148). He responded weakly: “Have you made a study of the implications of Soviet entry into the IMF? The first time I heard about this was when your Foreign Minister (Jobert) mentioned it to me last night.” Kissinger was afraid US influence over Western Europe would decline as each European member of NATO sought to curry favour with Moscow in pursuit of lucrative commercial contracts – contracts made possible by the détente he and Nixon had inspired the previous year. With the EEC, and France in particular, refusing to co-operate on his attempt to impose a new form of US leadership on the Western alliance through the “Year of Europe” initiative, it was plausible EEC states would see future advantage in admitting the USSR to the IMF. (This US-European adversarial negotiation is discussed at length in Kissinger, Years of upheaval, 152-94 and 700-34; note in particular Kissinger’s observation: “The opposition to us was led by Jobert, supported by Heath and tolerated by Brandt for their own reasons”; Ibid., 731.)

Pompidou returned to this theme in correspondence with Nixon (Not classified Letter from President Pompidou to President Nixon, 25 June 1973; Rasmussen, Foreign economic policy, 169-73). Anticipating US objections, Pompidou claimed it would be unreasonable to exclude the USSR from IMF membership, not least because Romania, a centrally-planned communist state favoured by the US, had been admitted to the IMF in 1972. This, Pompidou wrote, demonstrated there would no practical difficulties in admitting centrally planned economies. Pompidou continued “one can anticipate that in the future (the USSR) will attach a growing importance to three particular aspects of a system in which they will take part or to which they will be associated:

- the agreement on fixed exchange rates, which is indispensable in economies as fully planned as theirs.
- the definition of a numéraire which will be a desirable reserve instrument acceptable to them.
- the restriction of the *de facto* role of certain national monies as numéraire.”

Pompidou forecast détente would increase trade between the West and the USSR, making it inevitable the USSR would want to join the IMF and Europe would agree. Once the USSR was an IMF member, he argued, it would want the new international monetary order to be based on fixed exchange rates. (The Soviet Union ran COMECON, the communist states’ economic area, on a fixed exchange rate basis. Central planners had little use for price signals and price movements, including foreign exchange rates.) Moreover, as a major gold-producer, the USSR would expect gold to be the order’s main reserve asset, not a national currency and especially not the US dollar. Pompidou left implicit the threat that France and much of Western Europe would support the USSR in this.

representative at the EEC Monetary Committee, Derek Mitchell, HM Treasury, suggested a compromise formula for agreement at Nairobi:

- the EEC accepting the US indicators-driven approach to adjustment;
- the US accepting in return a “fairly strict” convertibility regime;
- all agreeing to establish an “average value/average interest rate” SDR; and,
- “provision” for dealing with existing reserve currencies.¹⁰²

France, foot-dragging, opposed the British proposal, arguing the EEC should not seek agreement with the US until it had resolved internal differences on individual elements of the C20 package. France reiterated its objection to early agreement at the following EEC Monetary Committee meeting.

British efforts to discover why France was procrastinating revealed the underlying French concerns. French Trésor officials revealed they were constrained by Giscard d’Estaing’s belief it was “completely illusory” to expect reform to be agreed in 1973 and that 1974 should be regarded as a reasonable final date.¹⁰³ Apparently Giscard assumed Washington would become more accommodating to Europe on asset settlement once the February and subsequent dollar devaluations had returned the US current account to surplus in 1974. There may have been some truth in this, but the real cause of France’s reluctance to settle was its unhappiness with the dollar depreciating after generalised floating began in March 1973.

Pompidou and Giscard d’Estaing had discussed the dollar’s competitiveness ineffectively with their US counterparts.¹⁰⁴ The problem was

¹⁰² Bank of England’s 26 June 1973 record of the EEC Monetary Committee meeting, 21-22 June 1973 (Bank of England archive file OV53/72)

¹⁰³ Letter from Derek Thomas, British Embassy, Paris, to J. G. L. Ales, HM Treasury, 28 June 1973, reporting his conversation with Henri Banquiest, Trésor. At the Reykjavik US-France Summit, Giscard took the same line in discussion with Shultz and Volcker on 31 May: “Minister Giscard said there was no serious chance of reaching substantive agreement by Nairobi, but that the world was expecting it. We had to dissipate that illusion. We needed at least two full ministerial meetings and some restricted contacts before agreements could be reached, which would mean early 1974 at best”. (Confidential Memorandum of Conversation, 31 May 1973; Rasmussen, *Foreign economic policy*, 146-57)

¹⁰⁴ Markets had depreciated the floating dollar by 5% at the end of May 1973 compared to the exchange rates agreed at the time of the “Volcker devaluation” in mid-February. Giscard d’Estaing had feigned indifference to this in Reykjavik when Shultz asked him whether the dollar’s lower value was causing France problems. The US record of the Shultz/Volcker/Giscard/Brossolette meeting shows “Secretary Shultz asked if the French had any problems operating with the existing system while work proceeded on reform. Minister Giscard said the present weakness of the dollar was not a problem for France.” (Confidential

re-stated vividly by senior Trésor officials in conversation with Geoffrey Littler, a senior HM Treasury official. When Littler complained France had been an obstacle to the C20's progress, allowing the US to continue running the international monetary system as a dollar standard, they assured him France was less afraid of a dollar-centred international monetary system than it was of reforms imposing onerous adjustment responsibilities on France through an early restoration of fixed exchange rates that would lock the dollar into a super-competitive exchange rate. "Exports", they explained, were France's "tractor of growth".¹⁰⁵ France was hoping a recovery in US competitiveness in 1972-73 would push it into trade and current account surplus in 1974, to which foreign exchange markets would respond by appreciating the dollar against European currencies. Only a higher dollar exchange rate would persuade France to accept and implement reform. Meanwhile France would procrastinate.

Two "Noises Off"

Reform was impeded in summer 1973 not only by French foot-dragging, but by some insistent "noises off": Watergate and the "Year of Europe".

Memorandum of Conversation, Reykjavik, 31 May 1973; Rasmussen, Foreign economic policy, 146-57)

Pompidou was more candid when raising the matter with Nixon, complaining of the dollar's "third devaluation" in two years. According to the US record of the Nixon/Kissinger/Pompidou conversation at Reykjavik, President Pompidou complained: "... nothing remains of the secret communiqué we both signed at the Azores, not even the rate of the U.S. dollar. President Nixon responded: "You are referring to the obligation we undertook to defend the U.S. dollar and the two devaluations that ensued." President Pompidou confirmed this, stating "The first devaluation was foreseen. Today, in fact, there is a third devaluation, in the sense that the dollar is quoted at 5% below the level it reached after the second devaluation." (Top Secret Memorandum of Conversation, Reykjavik, 31 May 1973; Rasmussen, Foreign economic policy, 158-65)

Giscard took up Pompidou's theme in a bilateral meeting with the US ambassador to France, Irwin, on 27 July 1973. He complained the dollar had depreciated 10% since February, making some French exports uncompetitive in the US market, forcing exporters to lay off workers. He demanded the US intervene in foreign exchange markets to defend the dollar. (Confidential telegram from the US embassy in Paris to the State Department reporting the ambassador's call on the French Finance Minister, 27 July 1973; Rasmussen, Foreign economic policy, 182-83). In fact the Federal Reserve had been intervening since 10 July to stem the dollar's decline, to little effect. (See "Foreign Policy Implications of the Dollar's Decline", Confidential Memorandum from Charles Cooper and Robert Hormats, NSC Staff, to the President's Assistant for National Security Affairs, Kissinger, 30 July 1973; Rasmussen, Foreign economic policy, 183-86)

¹⁰⁵ J. G. Littler's (HM Treasury) report of a conversation with M. Harberer and M. Bloch-Lainé, Trésor, 23 October 1973 (Bank of England archive file OV53/73).

Watergate poisoned Nixon's legitimacy. Connally described how Watergate "blew out the windows" as if it were a self-contained one-off event.¹⁰⁶ But it was more a case of Watergate's poison gradually seeping across the White House. Kissinger described it as a "rot".¹⁰⁷ Its initial impact on foreign affairs was minimal. As judicial and congressional pressures grew, however, Watergate intruded insistently, distracting the president, costing him staff and degrading White House efficiency and influence.¹⁰⁸ Kissinger described how power leached from the President and his White House staff to Cabinet members and their government departments.¹⁰⁹ Power also shifted towards Congress.¹¹⁰ With Congress increasingly unwilling to give the Nixon administration support, or even the benefit of the doubt, officials became reluctant to take initiatives requiring Congressional approval. In effect, the Foreign Economic Policy Executive was required to give greater weight to domestic political considerations than hitherto when weighing the need for responses to international pressures on the US.¹¹¹ As Nixon's legitimacy faded domestically, so too did the US' abroad. Thus senior policymakers, such as Shultz increased their autonomy from the White House, but the administration's

¹⁰⁶ Connally and Herkowitz, *In history's shadow*, 241

¹⁰⁷ Kissinger, *Years of upheaval*, 125.

¹⁰⁸ Kissinger records "early in 1973... I found it difficult to get Nixon to focus on foreign policy, to a degree that should have disquieted me. In the past, even in calm periods, he had immersed himself in foreign policy to enliven the job of managing the government, which ultimately bored him. Now it was difficult to get him to address memoranda. They came back without the plethora of marginal comments that indicated they had been carefully read. On at least one occasion Nixon checked every box of an options paper, defeating its purpose" (*Ibid.*, 77-78).

Roberts documented Watergate's effects in terms of it: tainting the President's reputation and legitimacy; diverting his attention from foreign affairs; causing his administration to disintegrate to the point at which vacancies went unfilled, killing Nixon's second-term plan to increase White House control over executive departments and agencies, thereby leaving these institutions to enjoy greater policy autonomy; and, narrowing the White House's perspective to tactical matters at the expense of strategy (see Roberts, "Foreign policy under a paralyzed presidency"). This had adverse impacts on various bilateral relationships. Simon recalled 90 senior vacancies appeared in the administration after Haldeman and Ehrlichman resigned, leaving large parts of the administration to be run, often badly, by "unconfirmed bureaucrats" who were "afraid to take risks" (Simon and Caher, *Time for reflection*, 102).

¹⁰⁹ Kissinger described the White House's control disintegrating during 1973-74 (Kissinger, *Years of upheaval*, 100-04).

¹¹⁰ Gelb and Lake observed Watergate broke "the President's stranglehold over Congress on national security issues" (Gelb and Lake, "Watergate and foreign policy", 177). Kissinger, commented on Watergate's impact on US foreign policy: "We were losing the ability to make credible commitments, for we could no longer guarantee Congressional approval" (Kissinger, *Years of upheaval*, 124).

¹¹¹ This helped explain Volcker's reluctance to agree C20 proposals that would require him to seek Congress' approval.

overall authority and power declined. US legitimacy was enfeebled; the US' critics, notably France, were emboldened. Markets were worried.¹¹²

Watergate distracted the Foreign Economic Policy Executive's attention from international monetary reform. Nixon's and Kissinger's "Year of Europe" initiative, however, created outright damage to reform.

Nixon had good reasons for an initiative aimed at revitalising the Western alliance. Changes in the international distribution of power were making the post-1945 alliance arrangements redundant. The Soviet Union had by 1972 achieved strategic nuclear parity, yet NATO's military strategy - and European defence spending - continued to assume US nuclear superiority. Increased economic interdependence since 1945 had created new trade, monetary and financial frictions that had not been addressed satisfactorily, in part because no new economic decision-making arrangements had been developed alongside the growing interdependence. The international economy had outgrown the G10 forum, as demonstrated by: the US' failed attempt to find a forum in which to discuss trade, monetary and security issues simultaneously; the C20 forum's creation; and, the need to reinforce the G10 when the decision was taken on floating in March 1973.

The transatlantic alliance needed updating to deal with the gap in military doctrine, various economic frictions and the absence of appropriate decision-making mechanisms. Reaching agreement would be difficult. Any solutions would have to give greater weight to European (and Japanese) concerns than had been the case in 1945. Calibrating this would be tricky: the US' insistence that it should provide leadership was undermined by the relative decline in US power since 1945 and by Watergate's reputational damage. Détente had become another complication, putting transatlantic unity under pressure. It weakened the bargaining power the US could obtain from its security predominance; European states were keen to compete with the US to profit from the new trade and diplomatic opportunities détente created. Europe had fewer reasons to co-operate with the US than at any time since 1945.

¹¹² The Governor of the Bank of England briefed the London clearing banks' chairman on 30 May 1973, reassuring them that "the present system of floating was working satisfactorily and had given us all breathing space. The effects of Watergate, for example, would have been much more damaging in a system of fixed parities." (Record of the Governor's Briefing for London clearing Bank Chairmen, 30 May 1973, Bank of England archive file OV53/71)

Nixon, distracted by Watergate, delegated to Kissinger the task of devising a new Atlantic Charter and ensuring Europe and Japan agreed it.

Kissinger worried about détente fragmenting the transatlantic alliance. Détente itself appeared successful in reducing superpower tensions and creating new opportunities for Western relations with the Soviet Union and Eastern Europe. This, however, implied the West's approach needed to be concerted and coherent if it were to avoid the risks of the USSR playing "divide and rule" with its new friends in Western Europe. Fragmentation within the transatlantic alliance could create new opportunities for the USSR to disrupt NATO's military cohesion: Brandt's Ostpolitik raised particular concerns in Washington. And European integration, strongly encouraged by the US when it appeared to bolster Europe's ability to resist Soviet pressures, was increasingly being framed in Brussels in terms that appeared to exclude a continued European commitment to a united West: the EEC was developing a habit of seeking European, not transatlantic, solutions to problems. Kissinger recorded "We (i.e. Nixon and Kissinger) concluded we must ensure against (the risks of internal divisions within the West) by tightening the bonds of Alliance - which was our starting point for the Year of Europe".¹¹³ These, however, were not the US' only motives for pursuing the Year of Europe: Nixon and Kissinger intended the Year of Europe to prolong US leadership and hegemony.

Nixon's and Kissinger's strong reaction to Brandt's letter of 2 March 1973 revealed their fear of Europe losing its habitual deference to US leadership and power.¹¹⁴ They saw European integration as creating a distinct economic pole in a multipolar world that would one day challenge the US. Kissinger wrote "I had always doubted Europe would unite in order to share our burdens or that it would be content with a subordinate role once it had the means to implement its

¹¹³ Kissinger, *Years of upheaval*, 148.

¹¹⁴ Not classified Message from Chancellor Brandt to President Nixon, Bonn 2 March 1973; Rasmussen, *Foreign economic policy*, 49-50. European states had closed their foreign exchange markets in response to massive outflows of dollars from the US to Europe. Brandt's letter informed Nixon that he and Heath had agreed to find a way out of the foreign exchange market crisis that would strengthen European integration. Brandt did not offer to consult the US on the solutions Europe might adopt. Nixon and Kissinger objected strongly to Europe ignoring US interests and immediately began to cast around for a retaliatory policy. Their first move towards disrupting European integration was to encourage EEC states to attempt a common float for their currencies against the dollar, while maintaining fixed exchange rates between European currencies (discussed in chapter 6).

own views.”¹¹⁵ He saw those views becoming different from the US’: “Europe’s main incentive to undertake a larger co-operative role in the West’s affairs would be to fulfil its own distinctive purpose.”¹¹⁶

Nixon feared the US would be unable to sustain its global leadership role much longer.¹¹⁷ His opening to China and détente initiatives were intended to shore up US hegemony, not create new economic and political opportunities for Europe.¹¹⁸ This, however, reinforced European suspicions of détente being a mask for a US-Soviet “Super-Yalta”; EEC states therefore vigorously pursued bilateral initiatives towards Moscow.¹¹⁹

Nixon and Kissinger recognised changes in the international distribution of power were disadvantaging the US. They feared European and US interests would increasingly diverge, with Soviet encouragement. They wanted transatlantic co-operation and consultation to be undertaken on Washington’s terms, promoting American interests. From Washington’s perspective, this required European states to be more compliant and less independent of the US than appeared to be the case in 1973.

Despite Kissinger’s claims to the contrary, he and Nixon were not above damaging European integration if that were what it took to weaken European states’ ability to resist US pressures.¹²⁰ Indeed, Nixon had earlier stated his position succinctly: “European leaders want to screw us and we want to screw them in the economic area.”¹²¹ Kissinger had encouraged FRG Finance Minister Schmidt to persuade fellow EEC states to adopt a common float against the dollar in March 1973 precisely because Shultz and Volcker had advised him Europe lacked the technical capacity and the political will to

¹¹⁵ Kissinger, *Years of upheaval*, 131

¹¹⁶ *Ibid.*

¹¹⁷ See chapter 3.

¹¹⁸ Kissinger admitted “We sought to discourage the Europeans from unilateral initiatives to Moscow” (Kissinger, *Years of upheaval*, 136).

¹¹⁹ This helped explain why Washington regarded as dangerously credible Pompidou’s speculation about European acceptance of future Soviet membership of the IMF.

¹²⁰ In his speech to launch the Year of Europe formally at the Waldorf-Astoria Hotel on 23 April 1973, Kissinger said “We will never consciously injure the interests of our friends in Europe or Asia. We expect in return that their policies will take seriously our interests and our responsibilities” (Kissinger, *Years of upheaval*, 153)

¹²¹ Secret Memorandum of Conversation, Executive Committee Meeting of the Council on International Economic Policy, 11 September 1972 (Duncombe, *Foreign economic policy*, 259-66)

operate and sustain such a system.¹²² Kissinger expected the common float to disintegrate, creating a major set-back for European integration.¹²³ With the Europeans divided and blaming each other for their currency Snake's failure, he would be better placed to obtain European states' agreement to the US' design for the new "Atlantic Charter", the proposed outcome of the Year of Europe negotiations. This, he expected, would entrench US leadership and bolster US hegemony; in Kissinger's words, "tightening the bonds of the Alliance".¹²⁴

Things appeared to be going to plan for Kissinger at first. He had been well advised by Shultz and Volcker on the Snake. The Europeans experienced serious problems in sustaining fixed exchange rates between their currencies while simultaneously floating their currencies against the dollar. There were too many moving parts for the Snake to operate smoothly as a fixed rate regime, but insufficient flexibility for a floating rate regime. The FRG was unable to hold down the value of the deutschmark against other Snake currencies and was soon forced to accept a market-driven 5.5% appreciation. It was either that, or absorb large capital inflows that threatened the FRG's anti-inflation policy.

Finance Minister Schmidt, annoyed by being forced to choose between the FRG's anti-inflation policy, its export-led growth strategy and its pro-EEC integration policy, said he would withdraw the deutschmark from the Snake rather than allow any further appreciation, irrespective of the implications for European integration.¹²⁵ France too became pessimistic, fearing disruptive international monetary problems. Pompidou wrote to Nixon to express his concern that if the Snake appreciated further against the dollar - and thus raised the dollar costs of stationing US troops in Europe - Congress would cut its costs by repatriating US forces from Europe. He believed this, in combination with

¹²² See chapter 6.

¹²³ Recent Greek-German tensions within the Euro area illustrate what Kissinger hoped to achieve.

¹²⁴ Kissinger, *Years of upheaval*, 148

¹²⁵ The US embassy in Bonn reported Schmidt telling the US ambassador, Hillenbrand: "One thing clear was that he would not personally be identified with any further formal revaluation of the German mark. He believed its over-valuation was already so great that, with the change in the business cycle he anticipated next year, German export industries would be hard hit as demand declined and it became obvious that their products had become over-priced in a contracting market. It was the first time (Schmidt) had said this, but if necessary the FRG would abandon the Snake and let the DM float alone rather than revalue again in any form. This would be both a political and an economic necessity for the German Government, despite the negative effect it would have on the movement towards European monetary union" (Secret telegram from the US embassy in Bonn to the Department of State, sent 5 July 1973; Rasmussen, *Foreign economic policy*, 174-76).

Brandt's energetic pursuit of Ostpolitik, would lead to Europe's "Finlandisation".¹²⁶ Giscard d'Estaing joined the gloomy mood, telling the US ambassador to France international monetary problems would impact on EEC, defence and security issues.¹²⁷

By July 1973 it was becoming clear Pompidou's and Giscard's initial assumption about the C20 negotiations was mistaken: time was not on their side. The longer the C20 dragged on, the less competitive France and Europe were becoming. And they were becoming vulnerable to US troop withdrawals. The latter would inevitably lead to splits within the EEC, especially between the FRG, which valued a US military presence highly, and France, which did not. Ostpolitik was already complicating their bilateral relationship: what was pursued enthusiastically in Bonn raised fears in Paris. By August 1973 the balance of argument was beginning to tilt towards France and the rest of Europe favouring an early settlement in the C20. This was an important development. Previously, a sense that US hegemony was weakening had encouraged "leash-slipping" behaviour by the US' European allies, giving credence to scholars who claimed this was an example of hegemonic stability theory in practice. Now, however, European fears of US hegemonic weakness and its consequences for their security were impelling Europeans to unite behind their US hegemon and ally.

Japan found itself reaching the same conclusion on the need to settle in the C20, and for similar reasons. The British embassy in Tokyo reported on 27 July 1973 that Japan now favoured an early return to fixed exchange rates and

¹²⁶ In his confidential telegram from the US embassy in Paris to the Department of State, 9 July 1973, the US ambassador to France, Irwin, reported on President Pompidou's pessimistic mood: "Pompidou reportedly is brooding over monetary crisis, disarray of Western camp and French impotence to change situation. He is said to portray Western Europe as on the brink of rapid and possibly brutal slide towards what he characterizes as "Finlandisation.... Particularly frustrating to Pompidou is that he sees no easy solution and believes that GOF has little control over events. France certainly intends to maintain its own defence posture and Pompidou reportedly just approved entire defence budget for the coming year, but the President is said to be keenly aware of French inability to do much to guarantee European security" (Rasmussen, Foreign economic policy, 176-77).

¹²⁷ Ambassador Irwin sent a confidential telegram to the Department of State, "Call on Finance Minister Giscard d'Estaing", on 27 July 1973, in which he observed "...it became clear that Giscard feels that U.S./European differences over the monetary situation can have important repercussions on other issues, particularly on the EC itself, and on defence and security questions. Resolving monetary problems would not resolve all other issues he said, but a failure to resolve the monetary problems would certainly exacerbate other issues" (Rasmussen, Foreign economic policy, 182-83).

was offering to broker a compromise between the US on adjustment and the EEC on convertibility.¹²⁸

Europe may have found circumstances pushing it towards an accommodation with the US in the international monetary negotiations, but elsewhere it was standing up to the US. French Foreign Minister Jobert was running rings around Kissinger's efforts on the Year of Europe. Perceiving the risks to European interests in dealing bilaterally with the US in the Year of Europe negotiation, EEC states had united behind a new form of external representation when dealing with the US. The EEC decided the chairman of the Council of Ministers would be its single spokesman and representative.¹²⁹ He would be empowered merely to state the EEC's position and to listen to the US; he was not authorised to negotiate. Any change in approach would have to be agreed collectively in Brussels. To his utter frustration, Kissinger found the USSR used "differential détente" to deal with EEC states on a "divide and rule" basis, whereas his attempt to achieve the same advantage for the US resulted in EEC closing ranks against him.

Kissinger Blocks Reform

Kissinger often approached international relations in the spirit of "carrots and sticks". Exasperated by the Europeans, he telephoned Shultz on 15 August 1973 to instruct him to use a stick. He wanted Shultz to halt progress on international monetary reform as a punishment for Europeans being "beastly" over the Year of Europe, and resume progress only when Europe had earned its carrot.

The transcript of the Kissinger-Shultz conversation reveals Kissinger aimed to leverage US economic and military power into obtaining a new Atlantic Charter agreement with Europe on US terms. Kissinger did not want to terminate international monetary reform; he merely wanted Shultz to postpone agreement until he and Nixon felt able to reward EEC states for accepting what Washington wanted in the Year of Europe negotiation. Kissinger told Shultz:

¹²⁸ British embassy, Tokyo telegram to the FCO, number 683 of 27 July 1973 (Bank of England archive file OV53/72)

¹²⁹ Chairmanship rotated every six months.

“One of the major things we have ... and that other nations want from us is in the area of economics. And we have no ability now systematically to sell it politically and we have a tendency to sell it on technical economic grounds on its own merits. Now take for example the international monetary thing. I think you're making good progress. At least I don't know what you're doing but I'm assuming from the expressions of satisfaction of Schmidt and d'Estaing that you are making good progress. That isn't really what we need because their governments are behaving in a beastly way towards us on the Year of Europe. And if they get from you on technical economic grounds, you see what I mean, a degree of co-operation that (they) don't show us elsewhere, we are just not expressing our economic policy adequately... All I would like to bring about though is a situation where we can tell the French if we are going to some form of convertibility and some form of exchange (rates) that we are doing that if they behave elsewhere. Are you still there? And not to give it away as just part of a technical monetary discussion. ...Now what I'm wondering, is it possible for you at Nairobi to hang tough - 'cause the Europeans in the meantime have been bastards - so that later on we can wrap up some concessions in the monetary field as part of more global negotiation.”¹³⁰

Shultz objected to international monetary reform being delayed to help Kissinger achieve his objectives. Shultz reminded Kissinger the US had committed itself to reform and that “(w)e have as much at stake as anybody in a monetary system that works.” Kissinger countered “they have as much at stake as anybody in the security system that works and it doesn't seem to affect them.” Shultz backed down, saying: “Well, I think we should see what we can see about it. That is, we have lots of prickly clicks in the negotiation. We won't finish in Nairobi.” Kissinger accepted Shultz's concession, restating his

¹³⁰ This and subsequent Kissinger-Shultz quotations are from the transcript of the taped Telephone Conversation Between Treasury Secretary Shultz and the President's Assistant for National Security Affairs, Kissinger, on 15 August 1973; Foreign economic policy, 190-93.

determination to deny the Europeans what they wanted on “convertibility” until they behaved acceptably in the Year of Europe negotiations.¹³¹

Kissinger had lobbed his spanner into the C20’s works immediately before the C20 Deputies meeting in Paris on 5-7 September 1973, a crucial meeting. If Finance Ministers were to reach agreement in Nairobi on Morse’ draft *Outline of Reform*, Deputies had to knock the draft into shape in the Deputies’ meeting.¹³² The draft *Outline* for the September Deputies meeting contained the compromises on adjustment agreed in July that favoured the US, but it was still relatively hard line (i.e. “European”) on asset settlement issues.¹³³ It contained no provision for an SDR/aid link. With Europe and Japan having accepted most of what the US wanted on adjustment, the negotiating dynamics now required both the US and Europe to soften their positions on payments issues, with the US giving most ground, and both the US and Europe to offer some concession to the developing countries on resource transfers and IMF governance. Liberal international theorists would have expected these concessions to have been made so all states would benefit from the international monetary co-operation that was apparently within their grasp. Yet this did not happen: Deputies made no progress.

Volcker recalled:

“I went to a key deputies meeting in Paris in September 1973, ready to accept the secretariat’s draft as a basis for discussion despite the need, as we saw it, for some key changes... It soon

¹³¹ Kissinger told Shultz: “(Europeans) have suddenly taken the position that they started to take on ... the devaluation in March that they would make specific rules from which we are excluded and then inform us of them, and inform us of them by an intermediary which the head of the foreign ministers conference which changes every six months who happens [to be] the Danish Foreign Minister in this period so you can imagine what kind of a negotiation we can have with them. So we are confronted with a bloc that makes ... confronted with a series of *faits accomplis* and a negotiator who has no authority. And that is totally unacceptable to us... Look basically you (Shultz) were right from the spirit of what we were trying to do, but what the Europeans were trying to do is use our overtures to build their identity in confrontation with us and they are doing it by picking the areas where it is safe. And sucking us dry in the areas where it isn’t and we’ve just got to put a stop to that.” (Transcript of the taped Telephone Conversation Between Treasury Secretary Shultz and the President’s Assistant for National Security Affairs, Kissinger, on 15 August 1973; Rasmussen, Foreign economic policy, 190-93) Kissinger’s complaint about Europeans making “specific rules” about which they would inform the US later was a reference to Chancellor Brandt’s letter to President Nixon of 2 March 1973, discussed in chapter 6.

¹³² The 5-7 September meeting was Deputies’ third opportunity to work on the draft. Morse had first put the draft to Deputies in May and then again in July.

¹³³ Specifically: foreign exchange market intervention, convertibility, the Substitution Account and SDRs.

became apparent the Europeans were in no mood to settle; by prearrangement or otherwise, one by one, they rejected the secretariat's *Outline*. Without the strong support from Japan or even Canada, both relatively passive participants, the whole effort began to look hopeless and I said so."¹³⁴

This was Volcker's second successive "destructive" intervention in a C20 Deputies meeting, and was exactly what Kissinger wanted.

The rest of the meeting was an anti-climax. Deputies agreed to establish three new technical groups.¹³⁵ But the main obstacles to agreement remained political, not technical economic questions. Deputies had been unable to muster enough political will - either in their preparations for the meeting in their capitals or in the meeting itself - to achieve the progress required and expected (of most of them) ahead of the IMF's Annual Meeting in Nairobi .

It marked the end of substantive effort to reinstate an international monetary order based on fixed exchange rates, although the negotiators did not realise it at the time. When Finance Ministers met at the IMF Annual Meeting in Nairobi on 24-28 September 1973, they were presented with Morse's incomplete draft offering nothing credible to discuss on reform.¹³⁶ Frustrated, they set a new deadline for completing the C20's work - 31 July 1974 – and attempted to accelerate progress by agreeing the "Big Five" (France, FRG, Japan, UK and US) should settle the main issues.

Shultz's report to Nixon on the IMF Annual Meeting was delayed by some 20 days.¹³⁷ When his account eventually surfaced, Shultz did not mention Kissinger's instructions to block progress on reform, instead placing the blame for reform's failure on Europe.¹³⁸

¹³⁴ Volcker and Gyohten, *Changing fortunes*, 123

¹³⁵ On adjustment, intervention and settlement, and consolidation and global liquidity

¹³⁶ Solomon, who had worked on the draft *Outline of Reform*, described it as "fuzzy, not only around the edges, but also in the middle" (Solomon, *International monetary system*, 258).

¹³⁷ This delay was telling, indicating the President's Watergate-driven disengagement from governance and the shift in power from the White House to government Departments.

¹³⁸ Shultz told Nixon there had been "considerable convergence and consensus as compared to a year ago. The major disappointment has been that Europeans have in recent weeks backed off from the more positive attitudes expressed in the July (C20 Ministers) meeting and have been trying to place the blame on supposed 'US intransigence'...Unquestionably, the European harder line on some aspects reflects their impatience to obtain from the US more sweeping convertibility commitments than we have been prepared to give." (Secret telegram,

Volcker's and Shultz's accounts were self-serving and should not be taken at face value. What really happened?

Shultz and Volcker approached September with seemingly good prospects for securing a basic agreement on an international monetary reform acceptable to the US at Nairobi. Any adverse domestic political pressures would be limited to grumbling from parts of Congress and academia.¹³⁹ The Foreign Economic Policy Executive could be primed for an agreement, with Shultz, Volcker and Burns lining up against Kissinger; Nixon was otherwise occupied by Watergate.¹⁴⁰ Shultz and Volcker had secured substantial

"Memorandum from Treasury Secretary Shultz to President Nixon", sent 18 October 1973: Rasmussen, Foreign economic policy, 194-95)

¹³⁹ At the domestic level, there was little constraint on Shultz's and Volcker's freedom of manoeuvre. The feedback from the businessmen and financiers on Shultz's Advisory Committee on the International Monetary System revealed they could live with floating exchange rates during the transitional period between March's floating and a C20 agreement. They supported Shultz's effort to build a new fixed exchange rate order based on adjustment indicators and graduated pressures, provided there was no premature return to convertibility (Shultz reported this to Nixon in his report on the IMF Annual Meeting in Nairobi. See his secret telegram, "Memorandum from Treasury Secretary Shultz to President Nixon", sent 18 October 1973; Rasmussen, Foreign economic policy, 194-95). Shultz and Volcker had kept Congress and the media informed of their plans and developments in the C20; they had not encountered substantive opposition (Shultz gave a press briefing on international monetary reform on 30 August 1973 in which he set out, not for the first time, US government views on exchange rates, adjustment, reserve accumulation and intervention. He took particular trouble to explain the difference between adopting floating as a transitional measure in the US proposals for the new international monetary order and the long-term use of floating as advocated by Friedman; see Bank of England archive file OV53/73). However, Watergate had weakened the White House relative to Congress such that Shultz and Volcker could not be sure Congress would necessarily support compromises they might have to concede in the C20, especially if these imposed new financial costs on the US.

Friedman pressed for floating exchange rates, as he had since his 1953 "Case for Flexible Exchange rates" article. Other prestigious academic economists opposed him. Michael Posner produced a paper, *The World Monetary System: A Minimal Reform Programme*, for the Brookings Institute in July 1972 in which he argued floating should be permitted only temporarily to deal with speculative pressures. (A copy is held in the Bank of England archive, OV53/43.) Professors Richard Cooper and Robert Triffin prepared a report for the Atlantic Council in which they argued exchange rate arrangements in a future international monetary order should be fixed but adjustable, with allowance made for "prompt, small and if necessary frequent changes in par values for countries in deficit as well as for countries in surplus". They also recommended sanctions against states refusing to adjust their exchange rates adequately. (Their views were reported in FCO telegram 2701 of 15 September 1972; Bank of England archive OV53/43.) Thus there was no academic consensus on floating, and certainly not a prevailing view that might limited the US Treasury's room for manoeuvre.

¹⁴⁰ A majority of the US Foreign Economic Policy Executive favoured the course Shultz and Volcker had charted. Nixon had given Shultz his full support before becoming disengaged through Watergate's effects. Burns strongly advocated a return to fixed exchange rates and offered practical support to Shultz and Volcker in international and Congressional meetings. Unless he felt certain of obtaining Kissinger's support, Burns was usually opposed to Kissinger's involvement in international monetary affairs, suspecting his intentions. As recorded in his diary, Burns did not feel he could rely on Kissinger at this stage: "I'm concerned about possible later effort by Nixon and Kissinger to corrupt the (international) monetary system because of some scheme of theirs, not clearly thought through, of breaking up – or at least causing difficulties for – the Common Market" (Burns and Ferrell, Secret diary, 95). Kissinger, as we

international support, and the remaining opposition could be managed if Shultz were prepared to buy off developing countries (with concessions on IMF governance and resource transfers) and compromise with Europe (on asset settlement and a “hard” SDR).¹⁴¹ Japan and France, and thus Europe, were seeking a deal. This configuration of domestic and international pressures pointed to a realistic prospect of agreement on an outline reform in the C20 on terms acceptable to the US in September 1973, although this was by no means a certainty. Yet Shultz and Volcker failed. The most likely explanation for this was Kissinger’s intervention with Shultz on 15 August. After that, the US never seriously attempted to obtain C20 agreement to its reform plan.

The British record of the fateful September C20 Deputies meeting paints a rather different picture of events to that Volcker recalled in his memoirs.

have seen, shared Shultz and Volcker’s visions for reform, but continued to have little interest in economic affairs. He saw international monetary reform as a carrot or stick to be used in support of his high-level political efforts to deliver a new Atlantic Charter through the Year of Europe initiative. He wanted the US to withhold agreement on reform in September 1973, using this as a stick until he had obtained Europe’s agreement on Year of Europe issues. But Kissinger did not have a veto over Shultz’s work. Had Shultz wanted to press ahead, there was little to stop him within the Foreign Economic Policy Executive. Whereas Kissinger’s Year of Europe negotiations were going badly with little prospect of success, Shultz was in a position to pull off an important and eye-catching international agreement that would help a beleaguered president politically. Doing so would doubtless anger Kissinger, but the influential Burns would have supported Shultz and advised Nixon to welcome the restoration of fixed exchange rates. In any case, Nixon was losing his grip over affairs discussed by Shultz, Stein, Ash and Burns in Quadriad meetings because of his increasing preoccupation with Watergate. Burns discussed how Watergate not only dominate Nixon’s thinking, but distorted the Foreign Economic Policy Executive’s decision-making. Burns recorded Shultz advising him on 2 May 1973 not to quarrel with proposals put to Nixon at a Quadriad meeting because, according to Shultz, “the President was too upset and could not concentrate” (Burns and Ferrell, Secret diary, 101).

¹⁴¹ Shultz and Volcker had secured considerable international support for the US approach to symmetrical adjustment and payment responsibilities, an SDR-based system, with adjustment to be informed by reserve-based indicators and, if necessary, stimulated by graduated pressures. The C20 meetings in July had revealed an international appetite for compromise, with other states making concession on adjustment issues. Moreover, Japan had said explicitly it was time to compromise in July and had offered to act as broker between the US and Europe. Taken together, this was evidence the US possessed enough positive structural power to enable it to change at least some of the rules of the international monetary game. But did the US have the power to overcome European resistance on payments issues and the SDR? Europe had not yet revealed compromise proposals on these issues and it would have been costly for the US to concede in September all the Europeans had previously said they wanted. France remained difficult, especially on convertibility and gold. But Pompidou’s and Giscard d’Estaing’s concerns about the depreciating dollar and general international monetary disorder damaging French and European trade and security interests indicated Paris now believed Europe could no longer play matters long in the face of the dollar’s on-going depreciation. Time was against them and the French leadership knew it. It was reasonable to suppose they might be willing to offer a bargain or even new unilateral concessions to the US to restore monetary stability. If France could be won over, so could the rest of Europe. As for the remaining negotiating bloc, the developing countries, the US reform proposals already offered them some of the outcomes they wanted, notably the ability to hold as large a share of their reserves in dollars as they wanted. But there was nothing from the US on their key demands: the SDR/aid link and IMF governance reforms. The price of their support remained to be determined, but ought to have been manageable for the US and Europe.

Whereas Volcker described EEC representatives ganging up to reject Morse's draft *Outline of Reform*, Derek Mitchell's (HM Treasury) record described how the meeting began with two EEC speakers (note: just two) criticising the adjustment section of Morse's draft. Mitchell reports this appeared to provoke Volcker into believing the EEC had gone back on what had been agreed. This was Volcker's reason, or more likely his pretext, for refusing US concessions on convertibility. According to Mitchell's record, Volcker thundered "you can't have good red meat on convertibility if you offer hash on the adjustment process".¹⁴² France then stepped in to articulate a "very hard line" to prevent other EEC states offering concessions to the obstructive US. In Kissinger's terms, Volcker had successfully avoided compromise and agreement.

Perhaps Volcker was genuinely disappointed and angered by the EEC representatives' perceived betrayal in the C20. He may have reacted strongly to this, negating the whole point of the Deputies meeting by withholding any US compromises. It is difficult to believe, however, that if Volcker had wanted a positive result, he would not have pushed harder to obtain it. He went into the Deputies meeting with a strong hand and was no push-over in negotiations.¹⁴³ Was he really knocked out of his stride for the whole of a three-day Deputies meeting by a couple of unhelpful early interventions by just two EEC states? Perhaps he actually did throw it all away in a moment of disappointment and anger, giving further substance to William Rogers' "rule" that "the United States never lost a war or won a conference". Perhaps this was one of many examples of a state failing to convert its power into its desired outcome. But what happened next in Washington casts doubt on the credibility of that explanation and strengthens the case for believing Volcker was exercising the US' negative structural power in support of Kissinger's Year of Europe tactics.

Rawlinson (British embassy Washington) sought Volcker's impression of the September C20 Deputies meeting. Volcker signalled the US was no longer aiming for early agreement on reform. Rawlinson reported a relaxed Volcker

¹⁴² D. J. Mitchell's Record of C20 Deputies Meeting, Paris, 5-7 September 1973 (Bank of England archive file OV53/73)

¹⁴³ Volcker was a skilled negotiator: recall how he secured the dollar's devaluation in a matter of days in February 1973, matching the devaluation Connally had spent months trying to achieve in 1971.

“felt that things are going in the right direction”.¹⁴⁴ Volcker made reform sound like a long job, saying he was looking forward to “the prospect over the months ahead of continuing... potentially fruitful detailed discussions of (C20) specifics, including indicators of adjustment and various schemes for convertibility”. Volcker insouciantly continued: “The US had given little thought to transitional issues (because) others were not interested”. This implied yet more time would be needed to clarify these issues. Volcker drove home his message by revealing “Shultz was considering concentrating his remarks on development issues and saying little about reform in Nairobi.”¹⁴⁵ Given that Nairobi was intended to focus on reform, Volcker’s message could not have been clearer: Washington had put reform on the back burner. This was exactly how Kissinger wanted Shultz to play the C20 negotiations: they had indeed been subordinated to progress on Kissinger’s Year of Europe negotiations.

What does this tell us about US power and hegemony? The US had demonstrated leadership in terms of the direction and pace of the reform effort. Volcker’s Plan X was at the centre of the C20 negotiations. The US had prevailed to a large extent on the issues it considered its priorities: symmetrical adjustment responsibilities by surplus and deficit states, to be achieved through use of adjustment indicators and graduated pressures; and, symmetrical rights to change the value of one’s currency, to be achieved by making the SDR the new order’s numéraire so the dollar’s par value, like that of all other currencies, could be stated in SDRs. The US had successfully resisted French attempts to give gold a larger role. But it had not been able to obtain European concessions on asset settlement issues or the SDR. The latter would greatly affect the cost of servicing the US’ post-reform SDR-denominated debts. The US had persuaded the rest of the C20 to make adjustment, not payments constraints, the main driving force behind establishing equilibrium in the new order. But it had failed to prevent Europe demanding Washington must show greater financial discipline in the new order than it had under Bretton Woods.

Both the US and Europe could consider their reform glass half full by September 1973. They had enough negative structural power to block each other’s plans, but neither had sufficient positive structural power to enable them

¹⁴⁴ A. K. Rawlinson’s record of a conversation with Volcker, Washington 13 September 1973 (Bank of England archive file OV53/73).

¹⁴⁵ Ibid.

to re-write all of the key rules of the game to suit themselves. Is this too harsh a judgement on the US' position? After all, until Kissinger's intervention it appeared highly likely Shultz and Volcker would obtain a satisfactory outline agreement at Nairobi, suggesting the US possessed the necessary positive structural power. But that would be to ignore the wider picture and the reasons for Kissinger's intervention. He wanted to postpone reform until Europe gave him what he wanted on his proposed Atlantic Charter. It was his inability to get his way, reflecting the US' lack of positive structural power more broadly, that caused Kissinger to attempt to leverage US economic as well as military power into his Year of Europe negotiations.¹⁴⁶

Kissinger never did get his way, providing further evidence that US structural power was not what many scholars advocating the concept claimed for it. The US was unable to use its positive structural power in the context of the international monetary crises of 1972-73 to strengthen its hegemony and also failed in the Year of Europe negotiations. The US did not have the structural power in 1973 Strange and other scholars claimed for it. But a further year remained for the C20 negotiators to do their work.

From Nairobi to "A Thin Conclusion", October 1973-June 1974

Within days of the conclusion of the Nairobi meeting Egypt had attacked Israel, Arab states had imposed an oil embargo on the US and the Netherlands, and OPEC had begun a process that would raise world oil prices fourfold within three months. This changed the structure of the world economy radically in three ways relevant to the C20's work, none of them helpfully.¹⁴⁷ The oil price

¹⁴⁶ Nixon and Kissinger also attempted to impose leverage on the UK to get what they wanted in the "Year of Europe", withdrawing US intelligence and nuclear co-operation until the British complied with US wishes (discussed in Hughes and Robb, Kissinger and the diplomacy of coercive linkage").

¹⁴⁷ Oil price increases created an urgent need to recycle oil exporting states' current account surpluses to oil importing states, for which new economic structures would be needed. Any blockage in the recycling process, such as capital controls, could render the importing state's currency instantly worthless internationally. Until the new recycling structures were in place, no one knew what a currency would buy tomorrow, still less what its fixed exchange rate value should be for the longer term. Henceforth, oil importing states would value free capital mobility more highly than fixed exchange rates.

The world economy faced structural current account surpluses in most OPEC states: they lacked the absorptive capacity to spend all their increased oil revenues on domestic

increase created a need to recycle oil exporters' current account surpluses to oil importing states; the latter began to value free capital mobility more than fixed exchange rates. OPEC's surpluses were structural and could not be addressed by the graduated pressures mechanisms in the US reform plan. And the problem of excess dollars in global reserves disappeared as oil importing states had to pay for their newly-expensive oil in dollars: the dollar surplus soon became a dollar deficit for many states.

It became fashionable in some quarters to claim the oil price increase was merely the excuse to abandon the C20 reform effort, not the cause.¹⁴⁸ But this overlooked the extent to which OPEC had changed the economic and political structures the new international monetary order was intended to serve. If one were expecting the world economy to be characterised by secular oil payments imbalances, it would not be sensible to continue with a reform intended to create a highly-structured fixed exchange rate order supported by elaborate rules for adjustment and payments aimed at penalising states running persistent payments imbalances. The two structures could not mesh. Their frictions would have been catastrophic for the world economy. And that is how matters appeared to the "Big Five" (G5) Finance Ministers when they met to

consumption and investment. Volcker's Plan X had addressed the need for adjustment from the perspective of an industrial country's traditional business cycle, a relatively short-term phenomenon. As Australia had pointed out in the C20, Volcker's approach could not deal appropriately with current account imbalances driven by medium-term commodity price cycles. Nor could it cope with a cartelised world in which oil exporters' surpluses would be both massive and enduring. And if oil exporters were going to experience structural surpluses, oil importers would have to endure structural deficits. Adjustment indicators and graduated pressures would have been irrelevant to the oil cartel. Had oil exporters cut back their exports in order to limit their balance of payments surpluses, the resulting supply shortages would have driven oil prices still higher!

The dollar overhang problem disappeared as fast as oil importing states moved into current account deficit. States thinking they had surplus dollar reserves in September 1973 soon discovered their reserves were too low as payments for dollar-priced oil rapidly depleted them. Dollar surpluses in reserves became dollar deficits, rendering Europe's proposed Substitution Account irrelevant.

¹⁴⁸ Geoffrey Littler, HM Treasury, produced a Background Note on international monetary reform for Sir Douglas Wass, the incoming Permanent Under Secretary to the Treasury. Littler argued: "There was a moment in July 1973 when some move towards compromise seemed possible, but this quickly became eroded and by September the antagonists preferred to argue rather than compromise. The emergence of the oil crisis was in my judgement an excuse, rather than a reason, for abandoning a discussion which had become fairly obviously irreconcilable" (J. G. Littler, Background Note for Mr Wass, 29 July 1974; UK National Archives file T354/285). Volcker shared this judgement: "By (January 1974), both the spreading oil crisis and the pervasiveness of inflationary pressures provided a plausible excuse (to wind up the C20 negotiation)" (Volcker and Gyohten, *Changing fortunes*, 123).

discuss international monetary reform for the first time at a chateau in Montbazou in the Loire Valley, on 24-26 November 1973.¹⁴⁹

The IMF Annual Meeting had agreed the G5 should meet to expedite international monetary reform. The secret British record of the first such G5 Finance Ministers' meeting showed Ministers were still traumatised by October's events.¹⁵⁰ Derek Mitchell (HM Treasury) assessed the 31 July 1974 deadline for completing the C20's work, agreed only a month earlier at Nairobi, was already out of reach:

"Shultz believes (the) deadline for the C20's work was not possible. Shultz, Burns and Volcker, without a common line, had clearly lost heart. Schmidt (was) impatient with the whole C20 panoply. Giscard, though to a lesser extent than the Chancellor (Barber), was concerned at how failure would look. (Giscard said failure) 'could not simply be blamed on the Arabs; the credibility of Finance Ministers would suffer.'"¹⁵¹

Keen to avoid the appearance of failure, if not failure itself, the Finance Ministers cast around for what might be salvaged from the C20's efforts. The list was short: SDR valuation, gold, and the role and structure of the IMF. According to Mitchell's record, it was agreed IMF reforms would be "cosmetic, (but) important to disguise the C20's failure". Ministers also agreed "The exchange rate regime was what it was going to be."¹⁵² Thus floating, agreed as a temporary expedient in March, was effectively permanent in the G5's eyes.

This *laissez faire* approach to the exchange rate mechanism proved to be the only way to reconcile the deeply-held differences between the US (favouring flexibility), Japan (wanting a competitive exchange rate), the FRG (international financial discipline through controls on global reserve-creation) and France (domestic financial discipline). Floating created exchange rate

¹⁴⁹ Gyohten commented on Arthur Burns gate-crashing this meeting, the only central bank governor to participate (Volcker and Gyohten, *Changing fortunes*, 134-35). He set a precedent for others, however, and a full set of central bank governors participated in subsequent meetings

¹⁵⁰ Derek Mitchell's Secret HM Treasury Record of G5 Finance Ministers Meeting, Montbazou, France, 24-26 November 1973 (Bank of England archive file OV53/74)

¹⁵¹ Ibid. Giscard's political credibility was especially important to him at that moment: he knew Pompidou was dying of cancer and that he would soon face a presidential election. Pompidou died on 2 April 1974. Giscard won the presidential election held in May 1974.

¹⁵² Ibid.

flexibility and validated the widespread adoption of capital mobility (including Washington abandoning its capital controls). “Managed floating” enabled Japan to set a competitive exchange rate for its export industries. Floating rendered control of international reserve-creation irrelevant because reserves were needed only if states chose to intervene to manage their floating exchange rates. Financial discipline was an inherent part of a floating rate system (perhaps to a greater extent than was appreciated at the time), albeit through disciplines imposed largely by capital and foreign exchange markets rather than central banks and the IMF.

The G5 decided to transform the C20 negotiation into an effort to achieve partial, not comprehensive, reform while minimising concessions to developing countries. The G5’s decision to bank what little had been agreed in the C20 and postpone all other reforms until more propitious times meant that fixed exchange rates, adjustment indicators, graduated pressures, convertibility and a Substitution Account were excluded from reform. British embassy official A. K. Rawlinson found Volcker “rather depressed” when calling on him in November to discuss the C20’s next steps. Volcker observed G5 Finance Ministers had agreed merely what they could not agree and that although “it might be possible to reform the IMF”, this would look “a thin conclusion” to the C20.¹⁵³

Volcker may have been depressed by September’s events and OPEC’s hammer blow, but he knew where his duty lay. The Year of Europe negotiations had turned acrimonious. Volcker continued to manufacture Kissinger-pleasing problems to delay what was left of international monetary reform. Rawlinson called on Volcker on 19 November 1973 and was irritated by him raising a spurious issue: who would take on the contingent liability to compensate SDR-holders in the event that the C20’s new order broke down? Rawlinson could not understand Volcker’s purpose, warning him the SDR’s legal backing was an “unnecessary distraction”, a “complication” and a “negotiating obstacle”.¹⁵⁴ But there was method in Volcker’s apparent madness. The US and EEC had fallen out spectacularly over the OPEC price

¹⁵³ A. K. Rawlinson’s Record of Call on US Treasury Undersecretary Volcker, 28 November 1973 (Bank of England archive file OV53/74)

¹⁵⁴ Letter from A. K. Rawlinson to Derek Mitchell, HM Treasury, Report of Conversation with Volcker, 19 November 1973 (UK National Archives file T354/385). A subsequent call by Rawlinson on Dewey Daane, Federal Reserve, reinforced Volcker’s message. Daane noted there was “waning enthusiasm” for reform in the administration. (Rawlinson’s Note for the Record, 23 November 1973; UK National Archives file T354/385)

rise, assistance to Israel and the Arab oil boycott. Kissinger had demanded a unified response from NATO member states but initially failed to consult allies about the US' intentions and actions, despite these affecting their national interests. Side-lined, EEC member states had at one point closed much of their air space to the US military providing aid to Israel; they began to make bilateral arrangements with oil exporting states without first seeking Washington's agreement. As in August, Kissinger did not want the US Treasury to co-operate with the Europeans until they fell into line.¹⁵⁵

Volcker and Burns, both at sea in a "no parity, no gold" world, clung to the idea a comprehensive international monetary reform was in US interests. Others in Washington did not agree because stable structures were now seen as more important than stable exchange rates.¹⁵⁶ Jack Bennett, Deputy Under-Secretary of the Treasury for Monetary Affairs, told Rawlinson US business and Wall Street "don't want... reform along the lines of stable parities" because this would provide less stability for them than would floating exchange rates.¹⁵⁷ Rawlinson objected, saying a breakdown in the C20 negotiations would be bad for international co-operation. Bennett countered that "worse would be an agreement on a new system which then collapsed". He revealed the US Treasury had been working on a plan intended to reconcile a return to par values and convertibility with adjustment in a world in which OPEC dominated the oil market. However, the US Treasury had found par values were now "impractical" and would have to be set aside.¹⁵⁸ Bennett claimed this outcome

¹⁵⁵ An internal Bank of England Overseas Office "Note on the US and International Monetary Reform", sent to the Governor on 4 December 1973, included the observation: "Nixon and Kissinger were intensely irritated by European and Japanese responses to Arab pressures and did not want (monetary) reforms that would help the EEC and Japan" (Bank of England archive file OV53/75). Shultz and Burns had voiced US concerns at the G5 Finance Ministers meeting on 24-26 November 1973. The secret British minute of this meeting recorded "Bitter complaints by Shultz at (the) failure of the EEC countries to back (the) US in supporting Israel... there was counsel in Washington that the US should not attend this (G5) meeting.... Burns urged that (the) Arabs should be recognised as having declared economic war. Counter-measures should be considered... He suggested withholding food and arms. (Was reminded the USSR could supply both.)" Giscard countered, explaining the EEC resented the way the crisis had been handled directly between Washington and Moscow; the EEC had not been kept in touch; in any case, the "EEC was not organised to take decisions in crisis situations." (HM Treasury's secret record of the G5 Finance Ministers meeting, Montbazou, France, 24-26 November 1973; Bank of England archive file OV53/74)

¹⁵⁶ This had been the minority view in the C20 Deputies meeting held in March 1973.

¹⁵⁷ A. K. Rawlinson's Note for Record of his conversation with Jack Bennett on 6 November 1973, sent to London 7 November 1973 (Bank of England archive file OV53/74)

¹⁵⁸ This appears to be a reference to a paper the US Treasury was preparing under Volcker's supervision for the C20 Technical Group on Adjustment and Reserve Indicators. Volcker discussed the draft paper with Rawlinson on 7 November 1973. Rawlinson reported

would satisfy the political pressures on the administration: businessmen outside New York, he said, were now sceptical of a return to fixed exchange rates and had been criticising the administration for “paying too much attention to New York bankers”.

Acceptance of floating as a long-term arrangement received increasing support in the US. Volcker strongly defended his fixed exchange rates objective in his testimony to Congress on 13 November 1973.¹⁵⁹ Yet he also demonstrated a new ambivalence on the subject, indicating he was becoming more open-minded. He observed that some states in the C20 negotiations (which had included the US) had wanted to limit floating to a temporary or transitional measure, adopted in “particular circumstances”. Volcker admitted the administration no longer believed this: floating “must not be so narrowly conceived” because it may be “the most effective and least disturbing course of action open to a country”.¹⁶⁰

Patrick Minford, British embassy Washington, reported on the same Congressional hearings:

“Congressional opinion is moving in favour of leaving the (international monetary) system in its present form of floating, but with some formulation for rules governing intervention... They (Congressmen at the hearings) are anxious that any reform arrangements should maintain the option to float very open, to be exercised by the national governments concerned and with no implications of unrespectability... Volcker confirmed this was the administration’s objective also”.¹⁶¹

their meeting in a letter to Derek Mitchell of 9 November 1973. Rawlinson observed “Volcker said he is troubled by the question whether a parity system is workable anyway.” (Bank of England archive file OV53/74) The US paper was discussed at the C20 Technical Group on Adjustment at its Washington meeting on 4-6 December 1973.

¹⁵⁹ Volcker told the Joint Economic Subcommittee on International Economics there was “no feeling (in the C20) that the collective float of March was a satisfactory substitute for reform”. He also emphasised “par values will remain the centre of gravity of the system” and that most states, “including the largest” will want to maintain “established exchange rates” (i.e. par values). (The transcript of Volcker’s statement is held in Bank of England archive file 8A212/1)

¹⁶⁰ Statement by Paul A. Volcker, Undersecretary of the Treasury for Monetary Affairs to a joint hearing of the Subcommittee on International Finance of the House Banking and Currency Committee and the Subcommittee on International Economics of the Joint Economic Committee on 13 November 1973 (transcript held in Bank of England archive file 8A212/1)

¹⁶¹ A. P. L. Minford, British embassy, Washington, Note for the Record, 13 November 1973 (UK National Archives file T354/385)

The following month Rawlinson reported Congressman Reuss, who remained influential in Congress on international monetary issues, had told him he now favoured floating, claiming Shultz and (less plausibly) Burns agreed with him. Reuss warned Rawlinson it would be “no disaster for the US if reform does not happen”.¹⁶² Kirbyshire, Bank of England, had also sensed the way the wind was blowing in the US. He briefed the Governor that the US business and agricultural communities were supported floating by November 1973.¹⁶³

With US domestic and Congressional opinion shifting in favour of floating exchange rates, Shultz was at last able to express openly his true, Friedmanite, views. On 7 January 1974 Rawlinson reported Shultz saying the world economy had evolved a system of “dirty floating” since March 1973 that had enabled it to ride out the oil price shock; he did not want to see a return to fixed parities, but the rules on exchange rate intervention needed to be made clearer; the C20 should now define what was “doable” on reform and the rest could evolve over time”.¹⁶⁴ The following day Reuss’ Joint Economic Subcommittee on International Economics published its report urging the administration to pursue a policy of “indefinite dollar float”.¹⁶⁵ A British CBI delegation visited the US Treasury in February and found Jack Hennessy, Assistant Secretary for International Affairs, claiming all was for the best: US policy had not changed, the world had; US policy was now “more realistic”. The difference between stable but adjustable exchange rates and “managed floating” was, in Hennessy’s view, a mere matter of “semantics”.¹⁶⁶

Like the Cheshire cat, the ideological basis of the US’ plan for international monetary reform was fast disappearing in Washington, with little remaining visible as C20 Ministers, Deputies and Technical Groups embarked on their final round of meetings (Table 7.4). Finance Ministers had to have something to show after all their efforts, but what?

¹⁶² A. K. Rawlinson, British embassy, Washington, Note for the Record of his lunch with Congressman Reuss, 13 December 1973 (UK National Archives file T354/385)

¹⁶³ R. A. Kirbyshire, Note for the Governor, 4 December 1973 (Bank of England archive file 8A212/1)

¹⁶⁴ A. K. Rawlinson Note for the Record of the ambassador’s and his farewell call on Shultz, 7 January 1974 (UK National Archives file T354/385)

¹⁶⁵ Summary of Joint Economic Subcommittee Report, issued 8 January 1974 held in UK National Archives file T354/385

¹⁶⁶ British embassy, Washington report of the CBI visit of Sir Michael Clapham and Campbell Adamson: Call on Jack Hennessy, US Treasury, on 12 February 1974 (UK National Archive file T354/385)

Table 7.4 C20 meetings held between IMF Annual Meetings in 1973-74		
Date	Level of meeting	Main issues discussed
14-15 January 1974	Deputies	SDR valuation; draft <i>Guidelines for Floating</i>
17-18 January 1974	Ministers	Oil crisis; how to proceed with reform; IMF <i>Articles</i> amendment
27-29 March 1974	Deputies	<i>Outline of Reform</i> draft; Technical Groups' reports
7-9 May 1974	Deputies	Differentiate between "immediate steps" and "longer-term issues"; <i>Guidelines for Floating</i>
10-11 June 1974	Deputies	Draft communiqué; unresolved issues
12-13 June 1974	Ministers	Final report to IMF Governors; <i>Outline of Reform</i>

When C20 Ministers met in Rome on 17-18 January 1974 they, like the G5 Finance Ministers in November 1973, simply wanted to clear the decks and end the negotiation.¹⁶⁷ Their attention was focussed on managing the OPEC-created international economic crisis. Ministers abandoned comprehensive reform and agreed to aim for a limited package of measures to be adopted in June. This would comprise agreements on the IMF's new structure, SDR valuation, "something" on adjustment and on managing floating. All else was to be set aside for later consideration.¹⁶⁸

Ministers demonstrated they were serious about wrapping up the C20 by agreeing in Rome the method for valuing the SDR against a basket of currencies and the IMF's new governance arrangements (four Ministerial meetings annually, of which two would be held at Deputy Finance Minister level). They instructed the IMF Executive Board to work urgently on designing a proposed new IMF Oil Facility to help oil importing developing countries. They told Morse to use the *Outline of Reform* document to "get a system written down

¹⁶⁷ Pursuing his vendetta against unco-operative European states, Kissinger had tried to insist the US boycott the meeting, as Burns recorded in his diary entry for 6 December 1973: "Kissinger tried to stop Shultz and me from going to the (Rome) meeting of finance ministers on monetary reforms. His reason: to show contempt for Europeans. He relented only when we reassured him ... that no agreement could be reached, and that we would underline the gravity of the political estrangement in our frank calls with the foreigners" (Burns and Ferrell, Secret diary, 113-14).

¹⁶⁸ Report on the C20 Ministers meeting, Rome, 17-18 January 1974 (Bank of England archive file OV53/76)

and agreed which (could) be put to use at some future time when the world is ready for fixed rates” and to have the revised document ready for Ministerial approval at their next meeting, April 1974.¹⁶⁹ Technical Groups were instructed to complete their work and report to Ministers by the end of April.

Technical Groups had been of little help to Ministers. British reports on their meetings described them as “rambling and superficial”, “inconclusive and tedious” and producing “little movement of substance”.¹⁷⁰ They satisfied no one. HM Treasury’s Roger Lavelle produced a secret brief for Derek Mitchell in December 1973 in which he warned “Technical Groups are failing to find agreed solutions to technical issues.”¹⁷¹ Morse had by then written a pointed letter to French Trésor Director Brossolette on 15 November 1973 warning him Technical Groups were making little progress and C20 participants should therefore prepare themselves to fail to meet the end-July deadline for the C20’s work set by Finance Ministers at Nairobi.¹⁷² Morse’s letter implied French obstructionism was creating delays, but it was more than that: Technical Group participants were refusing to exert themselves to produce technical solutions they knew C20 Ministers would not adopt.¹⁷³

The Technical Groups did, however, illuminate the US position’s disintegration and the tensions within the G24 developing country bloc in the C20. In December 1973 Volcker presented the Technical Group on Adjustment and Reserve Indicators with his attempt to reconcile the US reform plan with the new world of oil-induced structural payments imbalances. He all but threw in the towel on the US reform plan by proposing it would apply only to industrial countries, not all IMF member states. The intellectual credibility of the

¹⁶⁹ Morse’s description of the task C20 Ministers were about to give him when he met McMahon and Kirbyshire, Bank of England, in Basel in the first week of December; recorded in a Note for File, 13 December (Bank of England archive file OV53/75)

¹⁷⁰ These descriptions were included in three documents: FCO telegram number 476 of 24 October 1973 reporting on the Technical Group on Adjustment meeting, 23-24 October 1973 (Bank of England archive file OV53/73); British embassy Washington telegram number 34 of 25 January 1974 reporting on the Technical Group on Adjustment meeting of 24-25 January 1974 (Bank of England archive file OV53/76); and Bank of England Overseas Office’s report of 13 February 1974 on the Technical Group on Intervention and Settlement meeting in Paris on 6-7 February 1974 (Bank of England archive file OV53/76)

¹⁷¹ R. G. Lavelle’s secret brief on International Monetary Reform for Derek Mitchell, 4 December 1973 (Bank of England archive file OV53/75)

¹⁷² Letter from Jeremy Morse to Claude-Pierre Brossolette, 15 November 1973 (Bank of England archive file OV53/74)

¹⁷³ The British identified this as the main problem in the HM Treasury’s 29 January 1974 record of the meeting of the Technical Group on Global Liquidity and Consolidation, held in Washington on 28-29 January 1974 (Bank of England archive file OV53/76)

US' attempt to create a new fixed exchange rate order was irrecoverable from that point onwards.¹⁷⁴ Developing countries were similarly exposed in the Technical Group on the Transfer of Real Resources to Developing Countries, where divisions between oil exporting and oil importing developing countries, and also within the group of oil importing countries, served to block progress on the issues of greatest importance to them.¹⁷⁵

The US had lost its intellectual leadership of the reform process through Volcker's stumble in the Technical Group on Adjustment as surely as the G24 had lost some of the influence its earlier cohesion had commanded. With Volcker being described as a "lame giraffe", the way now seemed clear for France to lead the EEC in shaping the C20's final reform package.¹⁷⁶ But France, too, stumbled. Having championed an international monetary order

¹⁷⁴ The extent of the US' OPEC-induced problems with its plans for adjustment and graduated pressures surfaced in a meeting of the Technical Group on Adjustment and Reserve indicators, held in Washington on 4-6 December. Bennett had earlier warned Rawlinson (British embassy) the US was attempting to reconcile its plans for adjustment and graduated pressures with the new realities created by OPEC's oil price increases. When Volcker presented the Technical Group with his attempt at reconciliation his desperate effort to rescue Plan X lacked credibility and he must have known it. The British representative at the Technical Group reported "Volcker stated that oil countries would have to be treated separately (from the adjustment mechanisms previously envisaged) and that in practice developing countries could also be excluded." This was an extraordinary US retreat from its earlier insistence any plan for an international monetary order should be based on symmetrical rights and responsibilities for *all* IMF member states. Shedding symmetry, as Volcker proposed, reduced the US' plan for adjustment and graduated pressures - the key element in the new international monetary order as far as the US was concerned - to an effort merely to constrain the balance of payments surpluses that industrial countries were permitted to run with the US. Volcker's Plan X failed its first contact with economic reality.

¹⁷⁵ Developing countries had maintained an impressive unity in C20 Deputies and Ministerial meetings in 1972 and 1973 despite the growing economic divergences between the oil exporters and oil importers. The G24 had remained united in pursuit of an SDR/aid link, increased real resource transfers to the developing world and an increased voice for developing countries in IMF and World Bank governance. This unity held fast until a meeting of the Technical Group on Real Resource Transfers to Developing Countries on 3-4 February 1974. The only point on which all participants could agree was the need to meet again: divisions between the oil exporting and oil importing developing countries prevented agreement on anything else (Bank of England record of meeting; Bank of England archive file OV53/76). The prospect for the G24 achieving a lucrative success in the C20 end game negotiation led to even worse bickering within the G24 at the next Technical Group meeting, held in April. The squabbling over the spoils prevented the G24 from agreeing even which international institution should be responsible for delivering the resource transfers they wanted from industrial countries. (British embassy Washington telegram number 127 of 28 April 1974 described the G24's inability to agree whether the UN, World Bank, IMF or a new international organisation should be responsible for effecting the real resource transfers to developing countries; Bank of England archive file OV53/77.) This outbreak of disunity and disorganisation within the previously steadfast G24 bloc reassured industrial country participants in the C20 they would not have to pay a high price to obtain developing country agreement to concluding the C20 process.

¹⁷⁶ Kirbyshire, Bank of England, noted the "lame giraffe" phrase in his 13 May 1974 record of the C20 Deputies meeting in Paris, 7-9 May 1974 (Bank of England archive file OV53/78). Kirbyshire attributed the remark to members of the US delegation at that meeting.

based on fixed exchange rates defended by strong capital controls, the increased oil prices obliged France to withdraw its weakened franc from the EEC's fixed exchange rate Snake.¹⁷⁷ Having forfeited leadership of the EEC's first attempt at monetary union and suffered the political and economic shock of failing to sustain a fixed exchange rate for its franc, France's political leaders retreated in haste to ideological positions they knew the French population would support: opposition to floating and to reducing gold's monetary role.

When the IMF staff began work on preparing "Guidelines for Floating", as mandated by C20 Ministers at their April meeting, the French Executive Director, Larosière, warned the Executive Board France would not associate itself with any consensus on the matter.¹⁷⁸ Similarly, when EEC Finance Ministers met in June 1974, Giscard strongly opposed the idea of adopting an international monetary order based on floating exchange rates; he objected in particular the British draft of *Guidelines for Floating*.¹⁷⁹ He reverted to the idea of giving gold a greater role in the international monetary order and called for the EEC to increase the price of its monetary gold. When C20 Ministers held their final meeting in Washington on 12-13 June 1974, Giscard lodged a

¹⁷⁷ France had made a promising start on its post-Nairobi reform agenda. Finance Minister Giscard d'Estaing created room for domestic political manoeuvre by delivering a televised briefing for the French population on the outcome of the IMF Annual Meeting at Nairobi and in an interview with *Le Monde*. HM Treasury's Geoffrey Littler observed Giscard was at last beginning to prepare the French for the necessary policy compromises. (On 5 October 1973 J. G. Littler produced his own translation of an interview Giscard d'Estaing gave about the Nairobi meeting to *Le Monde*, which he circulated within HM Treasury with his comments, including: "the French government is at last preparing the French population for shifts in French demands and for compromise"; Bank of England archive file OV53/73.) But French policy was undermined by the impact of high oil prices on the French economy. The Trésor's Brossolette told Derek Thomas, British embassy Paris, the effort to write a new "Bretton Woods Charter" had been "naïve" and that Europe was being "impractical" in clinging to a fixed rate system (British embassy Paris telegram 35 of 10 January 1974, reporting Brossolette's conversation with D. M. D. Thomas; Bank of England archive file OV53/76).

When word got round of the French government shifting its position, there was confusion among France's EEC partners. Why, they asked themselves, was France championing the EEC Snake, a fixed exchange rate system, if it were "impractical"? The answer soon came: France announced it was withdrawing the franc from the Snake and adopting floating only two days after the C20 Ministers met in Rome. The EEC's Snake lived on; without the French franc, Italian lira and the British pound, however, it was a deutschemark zone in all but name. France's ambition to lead a currency bloc to rival the dollar had been crushed by the same oil price increases that had derailed Volcker's plans for the new international monetary order. France was no longer able to sustain a fixed exchange rate against the deutschemark within the Snake because oil price increases had pushed the French current account sharply into deficit and France lacked the FRG's capacity to export its way back to surplus quickly. Had the franc remained within the Snake, it would have been an obvious and profitable target for foreign exchange market speculators.

¹⁷⁸ British embassy Washington telegram 110 of 17 April 1974 reporting the IMF Board's discussion (Bank of England archive file OV53/77)

¹⁷⁹ FCO telegram number 1 of 7 June 1974 reporting the EEC Finance Ministers' discussion of international monetary reform (Bank of England archive file OV53/78)

“Reservation” rather than accept the emerging Ministerial consensus to downplay gold’s future role.¹⁸⁰ C20 Ministers squared the circle by mandating a further study of gold’s role.¹⁸¹ France continued to press for a revived role for gold in the IMF Executive Board on 14 June 1974, calling for central banks to be given the right to trade gold between themselves at market rather than official prices, and for a new system of market intervention to be created to stabilise world gold prices.¹⁸² The French intervention in the IMF Board was the opening shot in the negotiations that would continue from the conclusion of the C20 meetings to the IMF *Articles of Agreement’s* amendment in January 1976.

C20 Ministers’ negotiations ended in disarray in Washington on 12-13 June 1973. Morse presented Ministers with an enormous document detailing C20 Deputies’ discussions of the various reform issues, ostensibly to enable them to resume the reform process when the world economy was in better shape. Ministers sidestepped Morse’s invitation to extend the C20 process, endorsing instead the decisions Deputies had prepared for them on 10-11 June relating to IMF governance, resource transfers to developing countries, SDR valuation, gold, new codes of conduct for floating currencies and avoiding trade protectionism. C20 Ministers also agreed the IMF’s *Articles of Agreement* should be amended to establish the Interim and Development Committees, legalise floating, and incorporate a voluntary trade pledge and any future SDR/aid link. It was, as Volcker had foreseen, a thin conclusion.

Denis Healey, having replaced Anthony Barber as British Chancellor, tried to put a brave face on the outcome when presenting the C20’s conclusions to Parliament on 18 June 1974.¹⁸³ The minimalist result was unsurprising

¹⁸⁰ British embassy Washington telegrams numbers 200 of 12 June 1974 and 202 of 13 June reporting on the outcome of the final C20 Ministers meeting (Bank of England archive file OV53/78)

¹⁸¹ This decision resulted in the Théron Group being established to discuss gold’s role. It was a forum in which the US and France could bicker over gold. France seized the initiative by circulating a paper of 19 June for discussion at the Théron Group’s first meeting, in Basel on 24-25 June 1974. (Bank of England archive file OV53/78)

¹⁸² British embassy Washington telegram 208 of 14 June 1974, reporting the IMF Board discussion of the C20’s conclusions (Bank of England archive file OV53/78). The French proposal to stabilise world gold prices harked back to the Gold Pool, a pre-1968 arrangement dedicated to stabilising the world price of gold at the official price.

¹⁸³ See Hansard of 18 June 1974. (The verbatim text of Healey’s speech is held in the UK National Archives file T354/285.) Healey told the House of Commons C20 Ministers had agreed in Rome a comprehensive reform was “impractical” and had decided instead in Washington to take five specific steps to:

when the US, France and the EEC, and the developing world had, each for their own reasons, demonstrated their incapacity to lead. Their various tinkerings did not add up to much.¹⁸⁴ Healey's speech could not disguise reform's failure.

-
- rebuild the framework for international monetary co-operation by establishing the Ministerial Interim Committee (the C20 by another name) to run the IMF until comprehensive reforms could be agreed;
 - discourage a return to the 1930s' "beggar-thy-neighbour" trade policies by introducing new *Guidelines for Floating* and adopting a voluntary pledge against adopting new trade and current account restrictions;
 - help developing countries by establishing the "Witteveen oil facility", extending existing IMF lending facilities to help developing countries (the Extended Fund Facility), establishing a new Development Committee by drawing on the bodies running the IMF and World Bank, respectively, to study resource transfers to developing countries, and to reconsider establishing the SDR/aid link;
 - improve the SDR's effectiveness by basing its value on a basket of 16 major currencies and raising the interest payable on SDR-denominated loans from 1.5% to 5% for six months, and thereafter to be set at the average short-term interest rates in France, the FRG, Japan, the UK and US (the G5); and
 - enable central banks to use gold as collateral when borrowing, and studying sales of the gold held at the IMF to help pave the way for a larger reserve role for the SDR.

¹⁸⁴ C20 Ministers agreed at their Rome meeting, 17-18 January 1974, to create the Interim Committee in an effort to strengthen the level of political participation in IMF governance. The US suggestion to replace the members of the IMF's Executive Board - generally mid-level civil servants from national finance ministries or central banks - with the C20 Deputies (i.e. deputy finance ministers) was not accepted.

The C20 Deputies meeting in Rome on 14-15 January 1974 agreed there was a need for rules on floating (as reported in British embassy Rome telegram 44 of 15 January 1974; Bank of England archive file OV53/76). The C20 Ministers meeting in Rome, 17-18 January 1974, asked the relevant Technical Group to produce draft guidelines on managing floating by April. In fact the IMF staff took on the task, working from a draft *Guidelines for Floating* produced laboriously in the Bank of England in 1973, which Kit McMahon had sent to Morse on 28 November 1973 (Bank of England archive file OV53/74).

The US first tabled its "Trade Pledge" initiative at the C20 Deputies meeting in Washington on 27-29 March 1974 (reported in British embassy Washington telegram number 99 of 30 March 1974; Bank of England archive file OV53/77). The US initiative was a feeble echo of Connolly's attempt to open other states' markets to US exports. It required states merely to pledge to refrain from adding to their existing protectionist policies.

Witteveen replaced Pierre-Paul Schweitzer as IMF Managing Director after the US refused to endorse the latter's reappointment at the IMF Annual Meeting in 1972. Witteveen lobbied hard (and eventually successfully) in the latter part of 1973 and in the C20 meetings held in 1974. His intention was to create a new IMF facility to help hard-pressed oil importing developing countries. (Witteveen's efforts are described in FCO telegram number 550 of 6 December 1973 reporting on Witteveen's visit to London; Bank of England archive file OV53/75.)

G24 representatives put down a firm marker at the C20 Deputies meeting in Washington on 27-29 March 1974 they would not agree any reform package unless it included the Witteveen oil facility and the Extended Fund Facility. This earned them a hypocritical rebuke from Volcker, who said "Deputies should aim to deliver the collective good, not special interests" (as reported in British embassy Washington telegram number 99 of 30 March 1974; Bank of England archive file OV53/77). Developing countries agreed to the Development Committee's creation at the C20 Deputies meeting in Paris on 7-9 May 1974 (Bank of England's 10 May 1974 meeting record; Bank of England archive file OV53/78). The British representatives believed this was a necessary "sweetener" to secure G24 agreement to the C20's reform package.

The Bank of England's record of the meeting shows SDR valuation methodology was approved by C20 Ministers at their Rome meeting on 17-18 January 1974 (Bank of England archive file OV53/76).

Conclusions

Examining the C20 negotiation through the perspective of archived documents enables one to see through some of the clouds international relations theory has spread over the negotiation. One sees the US engaged seriously with the negotiation: at no time did it regard them as the “pantomime” Strange claimed. The US used some deception, playing for time in the C20 in the hope of obtaining a better result for itself in the Year of Europe negotiation. But this deception was issue-specific and intended to be time limited. There is no evidence the US systematically asked for one outcome from the negotiation while wanting another, as Gowan and others claimed. Nor is there evidence the US changed its mind in mid-negotiation and ceased to co-operate, preferring to pursue its objectives unilaterally, as Sterling-Folker claimed. Volcker’s vain efforts to have a version of the US plan adopted in December 1973 is evidence of the US’ sustained sense of purpose and its desire to achieve a co-operative, consensual outcome.

The archived evidence is unhelpful to scholars who claimed the US possessed the structural power it needed during 1969-76 to impose its preferred international monetary order on the world. The C20 negotiation saw the US’ structural power pitted against Europe’s. The US wanted to create a new international monetary order based on fixed exchange rates and an SDR numéraire; so, in essence, did Europe. However, the US wanted prompt, symmetrical adjustment, including exchange rate adjustment, to be the main mechanism that drove the new order towards equilibrium. Europe wanted a tight asset settlement system to be the equilibrating mechanism, with the onus for adjustment left on deficits states. The economic logic behind either approach was strong, but the political logics were very different. Europe objected to being put in a position where it would be forced to take adjustment measures because the US refused to live within its means. The US objected to tight asset settlement because it jeopardised Washington’s ability to fund its military and economic power projection policies. Neither the US nor Europe possessed the structural power necessary to impose its vision of a new international monetary order on the other, or the C20. But both possessed enough negative structural power to block the other, a point Shultz later

conceded.¹⁸⁵ Both were groping for a compromise when Kissinger's and OPEC's respective interventions disrupted the negotiations.

The archives also undermine scholars who claimed weakening US hegemony was the root of international monetary disorder during 1969-76. Bank of England and HM Treasury participants in C20 meetings recorded the US moving towards success in the C20 discussions in summer 1973, winning international support for the main elements of the US-proposed adjustment process. (Indeed, Kissinger's attempt to leverage US influence in the C20 negotiations to strengthen his hand in the Year of Europe negotiation reflected international belief the US was close to C20 success: Giscard d'Estaing and Schmidt had told him Shultz was doing well!) That still left agreement to be reached on developing country issues and the asset settlement mechanisms important to Europe. Neither appeared intractable. Developing countries were soon satisfied with the limited resource transfer and IMF governance measures cobbled together in five months in 1974. Kissinger and OPEC disrupted negotiations before a compromise on asset settlement was attempted, but early outline agreement had appeared possible because France began to accommodate US wishes in the C20, and where France led, Europe would generally follow. Paradoxically, archives reveal the helpful French behaviour resulted from France fearing any future US hegemonic weakness would adversely affect French security and prosperity.

Neoclassical realism provides a better explanation for what happened in the C20 negotiation than either structural power or hegemonic weakness-based explanations. The Foreign Economic Policy Executive was required to devise a foreign economic policy that would cope with international imperatives and domestic political pressures during a period in which both shifted dramatically against a background of a gradual decline in US relative power. The need to modernise the transatlantic relationship to cope with the decline in US relative power and OPEC's decision to quadruple world oil prices drove the changes in international imperatives.¹⁸⁶ Expensive oil caused huge current account imbalances; oil surpluses had to be recycled to deficit states. Exchange rates

¹⁸⁵ Shultz: "The alliance among other major countries was negative in character - strong enough perhaps to oppose any US effort, but not strong enough to pull together a concrete proposal that could serve as a basis for negotiations" (Shultz and Dam, *Economic policy*, 126).

¹⁸⁶ The Kissinger's Year of Europe negotiation was intended to tackle this.

became dependent on short-term factors, such as the volume of capital that creditors decided could be recycled to an oil-importing state: no durable fixed value could credibly be attached any exchange rate. Recycling and the world economy depended on free capital mobility. US banks seized their chance to lead the recycling effort; US business, agricultural and public opinion swung behind sustaining floating exchange rates, even criticising Wall Street for having supported fixed exchange rates for so long. The Foreign Economic Policy Executive, seeing this convergence of international economic pressures and domestic opinion, withdrew its plans for a new international monetary order based on fixed exchange rates, supporting instead continued generalised floating and free capital mobility. This was not US deceit or a shift to unilateralism, it was recognition of changes in the world economy's structures and the need to respond with a new international monetary policy.

Contrary to what one might expect from reading most Realist and Marxist analysis of the C20, the real winners from the negotiations were the G24, the developing countries' representatives. Their power rested on their collective ability to veto any change at the IMF, a negative structural power. Their objectives were limited: increased resource transfers to the developing world and an increased say in governance at the Bretton Woods institutions. They got both, albeit to a lesser extent than they had demanded initially. No one gets everything they want from a negotiation.

The other main C20 winner was not even present: international banks. OPEC created a huge demand for capital to be recycled from oil exporting to oil importing states. The US, having abolished its capital controls in January 1974, threw its weight behind allowing market forces to allocate capital internationally rather than governments or international institutions. The IMF's new, C20-created Oil Facility, although helpful to oil importing developing countries, was worth only SDR 3.2bn.¹⁸⁷ US negotiators blocked European efforts to strengthen the role of capital controls in the C20 Technical Group on

¹⁸⁷ To put this in perspective, HM Treasury forecast oil exporting countries' combined current account surpluses would reach some \$30-35bn in 1974 (see Derek Mitchell's secret record of the G5 Finance Minister's meeting held at Montbazou, 24-26 November 1973; Bank of England archive file OV53/74) and were on course for \$75 bn by 1980 (HM Treasury Note, "Oil Prices and International Monetary Reform: Investment Outlets", circulated within Whitehall by D. M. Thompson on 27 December 1973; Bank of England archive file OV53/75). Note that SDR 1 = \$1 at this time.

Destabilising Capital Flows.¹⁸⁸ The US wanted international banks, an area of US comparative advantage, to be the main vehicles for recycling. It resisted all C20 attempts to impose curbs on them. US opposition to the C20 creating a “strong” SDR also increased the chances oil prices and recycling would remain denominated in dollars, not SDRs.¹⁸⁹ Markets were left to set exchange rates, the most important price in most economies.

An international monetary revolution took place while the C20 met. The international community shifted its collective policy preference from a combination of national monetary policy independence and fixed exchange rates to one of national monetary policy independence and free capital mobility, sacrificing fixed exchange rates in the process.¹⁹⁰ This revolution was not the result of the C20 taking political decisions, or US structural power, or even US hegemonic weakness. Rather, it was prompted by national policymakers defending their national interests when confronted by new international imperatives resulting from OPEC’s higher oil prices and oil surpluses, under circumstances where policy choices were constrained by the laws of economics, i.e. the economics of choice within Mundell’s trilemma.

¹⁸⁸ Helleiner discusses US opposition to capital controls in the C20 negotiations at some length (Helleiner, *Re-emergence of global finance*, 107-22). In the Technical Group discussions, the US wanted to give the IMF the power to force states to abolish capital controls; EEC states and Japan wanted the opposite. Bundesbank Vice-President Otmar Emminger’s compromise proposal - that the IMF be given the power to insist on the introduction and removal of national capital controls as appropriate - was adopted, bringing the protracted Technical Group discussion to a close (Helleiner, *Re-emergence of global finance*, 110).

¹⁸⁹ The US, for example, was “defensive” in the Technical Group on Intervention and Settlement and resisted the proposal the SDR might be used as an intervention currency (report by the Bank of England’s Overseas Office, dated 13 February 1974, on the Technical Group meeting held in Paris on 6-7 February 1974; Bank of England archive file OV53/76).

¹⁹⁰ The majority of developing countries did not adopt floating exchange rates at this time, or later. However, the overwhelming majority of them were what might be termed “proxy floaters” because they pegged their exchange rate to the currency of an industrial country, usually the US dollar, but also the French franc or sterling, or a basket of industrial countries’ currencies. So the value of these developing country currencies floating in line with that of the industrial country currency to which they were pegged. Developing countries’ currencies were inconvertible and therefore were free of the sort of speculative attacks that could arise when two convertible currencies set a fixed exchange rate between them. Foreign exchange market speculators had no incentive to pile into, say, kwachas when there was no guarantee they could exit again when a profitable opportunity arose.

Chapter 8

To a “Modus Vivendi”

“I do wish these two young people could get along.”¹

This chapter covers the period between the end of the C20 negotiations in June 1974 and the agreement to amend the IMF’s *Articles of Agreement* in January 1976. This ended the 1969-76 international monetary crisis: the world began the transition to a new monetary order based on floating exchange rates and free capital mobility. Like chapter 7, this chapter focuses on order-building.

Despite Ford replacing Nixon in the White House shortly after the end of the C20 negotiations, the Franco-US tussle over the international monetary order’s rules continued unchecked. France wanted a return to something close to the rules agreed at Bretton Woods in 1944, with exchange rates fixed and gold given a prominent role as a reserve asset. The US wanted gold’s role reduced and a *laissez-faire* agreement on exchange rate rules. The US wanted to be allowed to float the dollar without international penalties; other states would be free to fix or float their exchange rates, a clear indication US hegemonic ambitions had shrunk. Washington no longer sought to exploit the international monetary crisis to strengthen US hegemony. Ford regarded the on-going international monetary dispute with France as an unnecessary and unwelcome distraction: his priority was to calm the post-Watergate domestic political turmoil and win the 1976 presidential election.

The C20 had concluded with Ministers agreeing the IMF’s *Articles* should be amended, but they had not agreed a text. The US and France squabbled over the drafting throughout the following twelve months. Both wished to impose their own long-term vision of the new international monetary order on the *Articles*; neither wanted the other’s prejudicial drafting to preclude their

¹ Punch-line of an awful joke British Prime Minister Harold Wilson told at the Rambouillet Economic Summit aimed at Presidents Ford and Giscard d’Estaing.

vision. By late 1975 the British, German, Italian and Japanese governments had wearied of the Franco-US bickering and agreed to accept whatever the US and France could agree bilaterally. Eventually compromises were achieved: France got its way on gold, the US on exchange rates. The IMF's *Articles* were formally amended at an Interim Committee meeting in Kingston, Jamaica, in January 1976.

Scholars interpret these events differently. Most Realists and Marxists ignore Washington's concession on gold and claim the US emerged victorious by using its structural power to change the international rules of the game to its liking once the C20 "pantomime" was over. Most Liberals, ignoring US success on legalising floating, saw a waning hegemon unable to impose its preferences on other states, and an international monetary order moving towards disarray. However, British and US archives point to different conclusions: the Foreign Economic Policy Executive chose to allow US domestic political concerns to drive foreign economic policy to the exclusion of US foreign policy interests in strengthening hegemony.

Archived materials reveal the US did not get the new rules it wanted on gold, indicating US structural power was not as sweeping as its Realist and Marxist advocates claimed. Watergate and OPEC had hobbled US legitimacy, leadership and power. The Ford administration dropped the Nixon administration's ambitious attempt to introduce a new, comprehensively reformed international monetary order and instead pursued narrow US national interests without regard for the international monetary order.

By mid-1975 Washington's exchange rate policy ambitions were reduced to seeking amendments to the IMF's *Articles* that would permit the US to float its dollar without penalty, while blocking French attempts to introduce mandatory fixed exchange rates for all states and penalties on states floating their currencies. The US achieved its exchange rate policy objective, but this highlighted Washington's hugely diminished ambition. It no longer thought in terms of imposing international monetary order through domination or by consent. It had abdicated monetary leadership, not exercised positive structural power. It did not care how many states took advantage of the exchange rate freedom it created for itself, nor did it pay attention to the consequent international structural implications, although it did initiate at the Bank for

International Settlements a limited amount of new work on order-building with regard to capital flows. The latter ensured the Bretton Woods regime's collapse was not followed by the "non-system" many Liberals feared; this also contradicted the bleak impression of minimal US contributions to international co-operation, the version of events Sterling-Folker emphasised.²

Archived materials demonstrate Ford did not approach international monetary issues from a hegemonic perspective. His priorities were domestic. He reshuffled his administration - the "Halloween Massacre" - to focus it on his 1976 election campaign.³ Having annoyed Congress and voters by pardoning Nixon shortly after taking office, Ford wished to minimise their discontent with his administration and give them reasons to support his presidency. OPEC had put the economy at the top of the political agenda. Ford could make common cause with Congress by continuing floating. Using the dollar as a shock absorber to protect the US economy from the disruptive repercussions of OPEC quadrupling oil prices would be popular.

Ford thought France's vision of a new, fixed exchange rate-based international monetary order would be politically unacceptable in the US and bad economics. He was a habitual consensus-builder, preferring to build legitimacy through compromise, not confrontation. Unsurprisingly, therefore, he compromised on international monetary issues, giving Paris most of what it wanted (for its own domestic political reasons) on gold in return for what Ford needed on exchange rates. This freed him to pursue his domestic political priorities: his re-election and what he saw as the US' long-term economic interest. The Rambouillet Economic Summit compromise was not a case of the US wielding structural power to impose a new international monetary order and restructure the world economy as structural Realists and some Marxists claimed; it was an example of domestic politics shaping US foreign economic policy without regard to the long-term, systemic implications. It was neoclassical realism in practice. Ford did not care what other states did with their exchange rates or their gold. He wanted to reduce US inflation, strengthen

² Sterling-Folker, *Theories of international co-operation*, 214

³ The so-called "Halloween Massacre" in November 1975 saw Ford effectively sack his Vice President, and his Defence and Commerce Secretaries as well as the head of the CIA and his re-election campaign team's Finance Director, and he demoted Kissinger. Ford announced his shake-up on 3 November 1975 (see Perlstein, *The invisible bridge*, 526-30, and Brinkley, *Gerald R. Ford*, 129-30).

the economy, minimise problems with Congress and, above all, to win the 1976 presidential election. If the two main pillars of the neoliberal international monetary order – floating exchange rates and free capital mobility - were created accidentally by Nixon, activating the order and unleashing neoliberalism was achieved by Ford's indifference to order-building.

This chapter discusses of these issues in six sections: changes in the Foreign Economic Policy Executive; gold policy; exchange rate rules; the Rambouillet Economic Summit; the period between Rambouillet and the IMF's *Articles of Agreement* being amended in January 1976; and conclusions.

Changes in the Foreign Economic Policy Executive

Ministers left many loose ends when they concluded their C20 negotiations in June 1974. Most involved translating their agreement into specific amendments to the IMF's *Articles of Agreement*. Amendments were needed to give effect to new governance arrangements, value the SDR, increase the IMF's resources for lending to developing countries and define the institutional conduits through which those resources would flow. Amendments were also required to legalise floating exchange rates and to alter gold's role in the IMF and the international monetary system. The US and France clashed repeatedly on the floating and gold amendments during 1974-75.

Hopes that C20 Deputies and officials would produce new draft *Articles* in time for the IMF's Annual Meeting in Washington in September 1974 were dashed immediately. Nixon avoided impeachment by resigning on 8 August. The US suddenly needed a new administration. Building one is a lengthy process, but most new presidents have the opportunity to use the period between their election in November and taking the Oath of Office in January to select their key appointments. President Ford had no such luxury: he was obliged to step into the job overnight. Given the need for haste, he retained most who had served under Nixon, but also brought in some new faces.

Ford's economic team comprised a mixture of the familiar and the new, mainly the familiar. The Foreign Economic Policy Executive initially comprised Ford, Simon (Treasury Secretary), Greenspan (chairman of the Council of

Economic Advisers), Burns (Federal Reserve chairman) and Kissinger (Secretary of State and National Security Adviser).⁴ Roy Ash was retained as Director of the Office of Management and Budget and a member of the Quadriad until Jim Lynn replaced him in February 1975.⁵ Nixon had replaced the exhausted Shultz with William Simon in March 1974, precipitating Volcker's resignation.⁶ Nixon replaced him with Jack Bennett, Volcker's assistant; Ford retained Bennett.⁷ Ford added the accountant William Seidman to his White House staff, appointing him Executive Director of Ford's new Economic Policy Board (EPB) on 30 September 1974. The main effect of these personnel changes was to strengthen the Foreign Economic Policy Executive's pro-market ideology.⁸

The EPB was soon required to come to grips with reforming the international monetary order: the IMF's *Articles* had to be redrafted and France, with European support, was digging in its heels, resisting US efforts to phase out gold's role as a reserve asset and legalise floating exchange rates.

Gold Policy

Demonetising gold in the new international monetary order was a US objective: Washington believed gold should no longer serve as a reserve asset.⁹ Simon told Nixon the final C20 Ministers meeting on 12-13 June 1974

⁴ Chapter 3 includes a more detailed discussion of the Ford administration's institutional arrangements, the personnel engaged in foreign economic policymaking and their ideologies.

⁵ Lynn, a lawyer, had served Nixon as Secretary of Housing and Urban Development since February 1973 and was retained in that capacity initially by Ford.

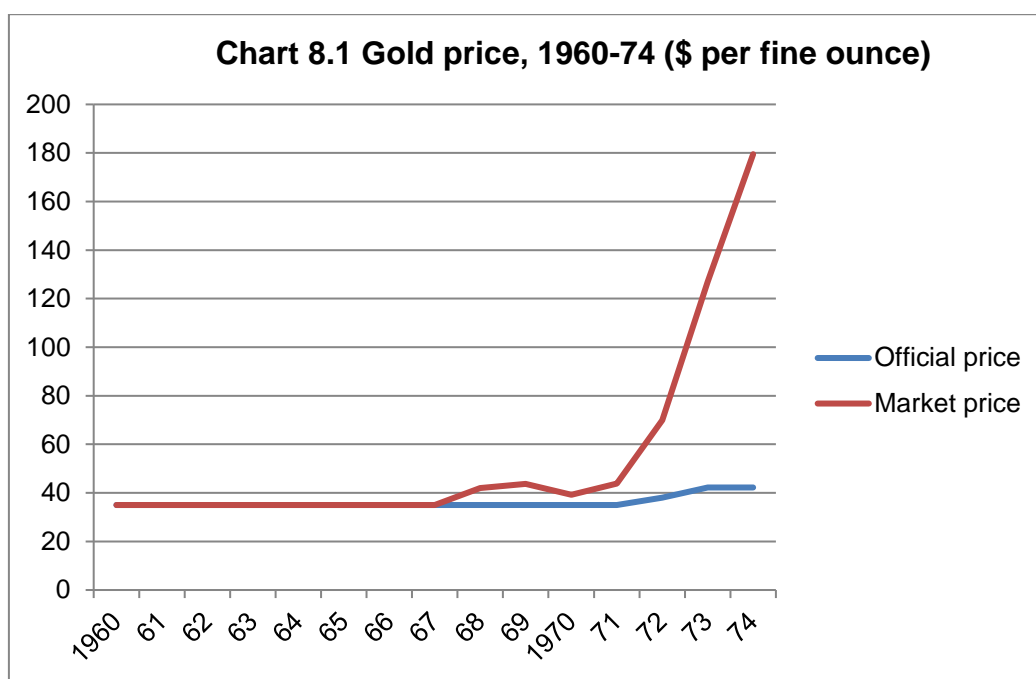
⁶ Nixon had persuaded a reluctant Shultz to remain within his administration several times. He relented in March 1974 when, according to Nixon, Shultz refused the president's request to stay, saying "I can't, Mr President. I'm just pooped." Nixon attributed this to Shultz having become "discouraged by the downturn in the economy and disillusioned by my handling of Watergate" (Nixon, *Memoirs*, 908-09).

⁷ Bennett shared Simon's pro-market ideology. In an article Bennett published shortly after resigning he argued: "... government efforts to influence exchange rates can cause the same types of problems as price controls in the domestic economy." He also stated "I see no reason why the second class status accorded to capital flows (under the Bretton Woods regime) should be revived" (Bennett, "A free dollar makes sense", 71). But Bennett lacked Volcker's knowledge and experience. Ford and Simon were therefore much less dependent on his technical advice than Nixon, Kennedy, Connally and Shultz had been on Volcker's. Archival materials do not suggest Bennett was especially effective in the EPB. I therefore exclude Bennett from membership of the Foreign Economic Policy Executive.

⁸ Discussed in chapter 3 above

⁹ Chapter 7 discusses the US objective of establishing the SDR as the new order's numéraire and main reserve asset. This implied gold would have no monetary role.

had accepted this: “We took some meaningful steps towards the outline of a new international monetary system - with gold replaced by SDRs.”¹⁰ This was an overstatement. The C20 had in fact agreed states could use their central banks’ monetary gold as collateral when borrowing abroad and, moreover, could value the collateralised gold at the market price, which was much higher than the official price (Chart 8.1). Gold was not dead as a reserve asset, but how much life was left in the idea of using it? Might the US yet succeed in demonetising gold when amending the IMF’s *Articles*?



Source: Thérion Group Preliminary Report on Mobilising Central Banks’ Gold Reserves, 5 July 1974 (Bank of England archive file OV53/78)

C20 Ministers’ reluctance to exclude gold from the new international monetary order reflected Italy’s desperate need to use of its gold reserves to help deal with its balance of payments problems; other states feared they too might find themselves in Italy’s position in the future.¹¹ Moreover, many states owned a considerable amount of gold (Table 8.1) and did not want to

¹⁰ Rasmussen, *Foreign economic policy*, 254

¹¹ Italy needed loans to fund its current account deficit, but potential creditors feared Italy might default on its debts unless they were guaranteed with collateral: Italy’s gold reserves were an obvious choice, but the gold price was problematic. Official price gold was much less valuable as collateral than that valued at the market price. This had important implications for how much Italy could borrow using its gold as collateral.

demonetise it, regarding it as a source of power.¹² Gold reserves had been “immobilised”, however, by the huge divergence between the official prices at which central banks were permitted to trade gold with each other, \$42.22 per fine ounce, and gold’s market price, around \$170 (Chart 8.1). Central banks were reluctant to sell their gold at the official price because that price might be abolished or raised. Italy’s solution was to “reactivate” its gold reserves by using its gold as collateral and valuing it at market prices. European C20 members prevailed on the US to accept this; the solution was duly written into the C20’s conclusions.¹³ Thus the C20 had not replaced gold with the SDR as Simon claimed. The pressures to activate central banks’ gold reserves intensified after OPEC raised oil prices, creating large trade imbalances.¹⁴

¹² States regarded gold as a hedge against the inflation affecting paper currencies, an important, internationally-tradable asset and, above all, as their war chest. Gold was distilled power, “The Sinnews of our wars, The terror of our Enemies” in mercantilists’ eyes (Mun, England’s treasure, 83 and 88). This theme runs through Kwarteng’s *War and Gold*. The links between gold reserves and war went back to at least sixteenth century Spain (Kwarteng, *War and gold*, 18-19). Kissinger asked a meeting of his senior State Department officials why EEC states remained so attached to gold as a reserve asset, Thomas Enders, Assistant Secretary of State for Economic and Business Affairs, observed Europe’s position was explicable in terms of power: “Although we have some substantial gold holdings, about \$11 billion, a larger part of the official gold is concentrated in Western Europe. That gives them the dominant position in world reserves and the dominant means of creating reserves. We’ve been trying to get away from that into a system in which we control (reserve-creation)... it’s a question of who has most leverage internationally. If they have the reserve-creating instrument by having the largest amount of gold and the ability to change its price periodically, they have a position relative to ours of considerable power. For a long time we had a position relative to theirs of considerable power because we could change gold prices almost at will. This is no longer possible... therefore we have gone to Special Drawing Rights... which spreads power away from Europe.” (Secret Minutes of Secretary of State Kissinger’s Principals and Regionals Staff Meeting, 25 April 1974; Rasmussen, Foreign economic policy, 232-39)

¹³ See, for example, Chancellor Schmidt’s letter to Nixon of 7 June 1974, in which he described Italy’s and France’s balance of payments positions as “critical”, making it essential for them to reactivate their gold reserves to avoid “catastrophe” in Europe and “consequences of unforeseeable magnitude” (Rasmussen, Foreign economic policy, 252-54).

¹⁴ Wallich warned to Burns other states needed to maximise use of their gold reserves to help them cope with oil price increases; (Not classified) Memorandum from Henry Wallich, member of the Federal Reserve System Board, to the Chairman of the Board, Burns, 13 December 1974; Rasmussen, Foreign economic policy, 273-74).

Table 8.1 Selected states' Official Reserves, end June 1974 (\$bn)¹⁵		
	Total reserves	of which Gold
United States	14.9	11.7
Germany	34.2	5.0
France	8.2	4.3
Switzerland	8.4	3.5
Italy	5.3	3.5
Netherlands	5.5	2.3
Belgium	4.6	1.8
Canada	6.1	0.9
Japan	13.4	0.9
United Kingdom	6.7	0.8
World	195.2	43.1

Simon used a G5 Finance Ministers and Central Bank Governors' meeting at Champs-sur-Marne (near Paris) on 7-8 September 1974 to press for gold demonetisation. He urged fellow Finance Ministers to support the US objective of phasing out gold's use and adopt a US proposal:

- Central banks should be permitted to sell up to 10% of their gold stocks on the private market over a three-year period;
- Central banks would be allowed to buy gold from the private market, provided they make no net purchases over a twelve month period;
- Central banks may use gold valued at market prices as collateral when they borrow (as agreed by C20 Ministers);
- Central banks should be free to buy and sell gold at market prices among themselves;
- The official price of gold should be abolished by removing all references to it from the IMF Articles;
- The obligation to conduct transactions with the IMF in gold should be abolished;

¹⁵ Source: UK Chancellor's Steering Brief for G5 Finance Ministers' meeting, 7-8 September 1974, circulated by C. W. Fogarty (HM Treasury) on 3 September 1974 (Bank of England archive file OV53/80) Note: gold is valued at the official price, \$42.22 per fine ounce in this table. The "World gold" figure excludes the \$6.7bn of gold held by the IMF, BIS and EPU.

- The IMF should sell some or all of the gold member states had deposited with it as part of their quota subscriptions;
- US residents should be able to buy gold from the Federal Reserve, to be achieved through the Federal Reserve beginning gold auctions in January 1975.¹⁶

Simon received no support at Champs-sur-Marne. His G5 peers were under little pressure: they probably knew US policymakers were divided over gold policy.¹⁷ His hosts, while reiterating their commitment to France's stated policy of reducing gold's international role, somewhat illogically also declared their hopes of removing all restrictions on central bank transactions in gold. This, as Simon and Burns were aware, would enhance gold's role in the new international monetary order.¹⁸ Jean-Pierre Fourcade, the replacement for Giscard as Minister of Economy and Finance when the latter became President, said France shared the US' objective of demonetising gold, but only in the long term. He was unhappy with the pace and direction of Simon's proposed reforms. Fourcade argued the official price of gold should be raised to a "realistic" level of around \$150 per fine ounce; central banks should be free to buy and sell gold between themselves and with the private sector without restriction; central banks should be responsible for stabilising the gold market, not prevented from doing so as Simon wished; the IMF should continue to use

¹⁶ Congress enacted legislation on 29 May 1974 giving US residents' new rights to buy gold from the Federal Reserve and retain it for private purposes from 1 January 1975. The Treasury's measures are listed in a confidential, undated Letter from Treasury Secretary Simon to the Chairman of the Federal Reserve System Board, Burns, sent in June 1974; Rasmussen, Foreign economic policy, 242-44.

¹⁷ Simon had attempted to persuade Burns to agree to support the Treasury's gold demonetisation measures in June, but with limited success in the face of Burns' caution and obduracy. In the past Burns had had no qualms in revealing divisions within the US economic policy making process to his central bank colleagues in BIS meetings. (For example, without revealing his role to others in the Foreign Economic Policy Executive, Burns had been the moving force behind the BIS' attempt to persuade Connally to end his procrastination policy in autumn 1971 which culminated in Zijlstra presenting Connally with a secret - and unwelcome - exchange rate realignment plan; see chapter 5 above.) With Burns unsympathetic towards Simon's proposals on gold, it is reasonable to assume Burns also shared information at the BIS on the US administration's internal splits over gold policy.

¹⁸ See Simon's analysis in his Martinique Summit briefing for Ford: *Our Negotiations with France on Gold*, undated Confidential Memorandum from Treasury Secretary Simon to President Ford, apparently prepared in November 1974; Rasmussen, Foreign economic policy, 270-72

gold, but value transactions at market prices; and gold should continue to play a key, if not central role, in the new international monetary order.¹⁹

The Franco-US gold dispute rumbled on. As well as repeating Fourcade's demands at the Franco-US Summit meeting in Martinique on 15 December 1974, Giscard told Ford he opposed all IMF gold sales and planned to revalue France's national gold reserves, raising their (national) valuation from \$7bn to \$12bn.²⁰ Ford's response, that his administration intended to auction 2 m ounces of Federal Reserve gold to US residents in early 1975, left Giscard unimpressed.²¹ He offered Ford an apparent concession by agreeing to remove all references to gold from the IMF's *Articles*. This would have the effect of abolishing gold's official price and ended the obligation on (but not the right of) member states to use gold in their transactions with the IMF. Giscard's offer was entirely self-serving. With no official price for gold, central banks would value their gold at market prices, as France was planning to do, and then trade gold at the higher prices, ending gold's "immobilisation" in national reserves. And if future transactions with the IMF need no longer include gold, members could argue the IMF would not need the gold originally deposited with it. The gold could be returned to the states that had originally deposited it, thereby boosting French gold reserves.

Giscard, whatever his personal views on gold, was boxed in politically by the domestic popularity of his efforts to defend gold in the international monetary order.²² The Right, gold-loving Gaullists, would have criticised him had he accommodated Simon's demands on gold, while the Left, anti-American socialists and communists, would have criticised him for caving in to US pressure.²³ Moreover, France's independent gold policy generated international

¹⁹ Fourcade distributed a paper on gold, drafted by Larosière, to G5 Finance Ministers on 26 September 1974. The British Chancellor's copy is held in Bank of England archive file OV53/80.

²⁰ French gold reserves' official value remained unchanged, however. See Secret Memorandum of Conversation, Martinique, 15 December 1974; Rasmussen, Foreign economic policy, 275-77

²¹ It left the US public unimpressed too. They bought only 750,000 of the 2 million ounces auctioned (Sobel, Fickes and Clifford, *Ford and the economy*, 226)

²² Simon understood the political limitations on Giscard's freedom of manoeuvre: see *Our Negotiations with France on Gold*, an undated Confidential Memorandum from Treasury Secretary Simon to President Ford, apparently prepared in November 1974; Rasmussen, Foreign economic policy, 270-72

²³ Derek Thomas, British embassy Paris, sent a letter to C. W. Fogarty, HM Treasury, on 6 September 1974 that provided a perceptive summary of French gold policy, emphasising its roots in French domestic politics. (Bank of England archive file OV53/80)

political advantages for him, including winning EEC states' support. Schmidt, prioritising close relations with France in pursuit of European integration, was prepared to back France in its tussle with the US over gold, even though gold was marginal to FRG interests.²⁴ Other EEC states also supported France: their Finance Ministers agreed a common policy on gold in April 1974.²⁵ Thus the battle lines over the international monetary order's future had been drawn, yet again, as the US v France, the EEC's "champion".

The battle resembled trench warfare for the next six months with neither side changing its position. Bizarrely, Federal Reserve Governor Wallich tried to break the stalemate by suggesting additional restriction on gold, in effect hardening the US position. He proposed all IMF member states set both a global ceiling on gold reserves based on their May 1975 levels, and future cuts in this ceiling. Burns proposed each state should be allocated a share of this global ceiling and the future cuts.²⁶ Simon added this to the US' negotiating line on gold for a G10 meeting, held on 13 May 1975 and was rebuffed: most G10 states were EEC members.²⁷

²⁴ Rasmussen, *Foreign economic policy*, 252. Gold constituted more than half of France's total official reserves, but less than 15% of the FRG's reserves, in part because the FRG had agreed with the US not to convert its dollar reserves into gold (see Table 8.1 and chapter 4).

²⁵ Europeans had strong political and economic reasons to support a common gold policy. Politically it reinforced their integration policies and strengthened their currency Snake, which France had quickly re-joined after the franc's departure in January 1974. Economically, they were all oil importers and under balance of payments pressure after OPEC raised oil prices; retaining gold as a reserve asset and raising its value helped strengthen EEC states' ability to cope with bloating current account deficits.

In defence of their collective interests, EEC Finance Ministers sent senior financial representatives - the Dutch Finance Minister, Duisenberg, and the President of the Dutch central bank, Zijlstra - to Washington in an unsuccessful attempt to persuade the US to support central bank freedoms to buy and sell gold on the private market. The Duisenberg/Zijlstra mission was discussed in the State Department, where Kissinger's main concern was, once again, that EEC states were again taking initiatives affecting US interests without prior consultation with the US. (See Secret Minutes of Secretary of State Kissinger's Principals and Regionals Staff Meeting, 25 April 1974; Rasmussen, *Foreign economic policy*, 231-37) Kissinger's fear of the US losing its leadership position led to him urging Simon and Burns to agree a US policy on gold quickly so as to prevent EEC states from taking unilateral actions at US expense. (See Confidential Memorandum from the President's Counsellor for Economic Policy, Kenneth Rush, to President Nixon, 4 June 1974; Rasmussen, *Foreign economic policy*, 249-52) According to Burns' diary entry for 19 April 1974, Kissinger also asked him to help him identify the best way of damaging French interests (Burns and Ferrell, *Secret diary*, 124).

²⁶ See Letter from Chairman of the Federal Reserve System Board of Governors, Burns, to President Ford, 3 June 1975; Rasmussen, *Foreign economic policy*, 286-90

²⁷ See *Proposed Understanding with Respect to Gold*, an unclassified paper prepared in the US Treasury for the G10 meeting held on 13 May 1975; Rasmussen, *Foreign economic policy*, 285-86

The Treasury and State Department recognised US policy on gold was already too restrictive in European eyes; adding the Federal Reserve's even more restrictive policy would be counter-productive in international negotiations. Thomas Enders, Assistant Secretary of State for Economic and Business Affairs, predicted accurately: "France will never accept (Burns-proposed) country limits on gold holdings. If we insist on this point, there will be no agreement reached on gold at this time. This is undesirable."²⁸ Enders reminded administration colleagues of the Treasury's fear of the EEC transforming its currency Snake into a gold-based currency bloc.²⁹ He also worried US obduracy would prevent Washington winning support for its proposal to sell IMF gold to help subsidise IMF lending to developing countries.

On his return from May's G10 meeting, Simon advised Ford: "(The other governments') overwhelming view at the moment is impatience with what they regard as the theological squabbling between the US and France. They would view a US/France agreement with great acclaim."³⁰ Claiming Kissinger's agreement, Simon argued failure to reach agreement on gold at the forthcoming Interim Committee meeting on 10-11 June would be a blow to US prestige while a US concession might help some French allies switch their support to the US.

Ford accepted Simon's advice. He wrote to Chancellor Schmidt on 6 June, informing the German Chancellor he was watering down Burns' proposal for national, reducing gold ceilings.³¹ However, the proposed concession was miserly.³² Ford revealed his underlying fears to Schmidt when he offering it: "We must ensure that there is no opportunity for governments to begin active trading in gold among themselves with the purpose of creating a gold bloc or reinstating reliance on gold as the principal international monetary medium." He asked for Schmidt's support in the Interim Committee meeting. Four days later

²⁸ Confidential Memorandum from the Assistant Secretary of State for Economic and Business Affairs, Enders, to the President's Assistant for Economic Affairs, Seidman, 4 June 1975; Rasmussen, Foreign economic policy, 295-96

²⁹ The emergence of rival currency blocs remained a nagging fear in the US Treasury too, where it could be traced at least as far back as 1969. See, for example, the Volcker Group's confidential paper on "Long Term Aspects of US International Monetary and Exchange Policy", circulated in January 1969; Duncombe, Foreign economic policy, 295.

³⁰ Confidential Memorandum from Treasury Secretary Simon to President Ford, 3 June 1975; Rasmussen, Foreign economic policy, 290-96

³¹ (Not classified) Letter from President Ford to FRG Chancellor Schmidt, 6 June 1975; Rasmussen, Foreign economic policy, 296-98

³² The proposed, highly restrictive, concession was for the US to accept increases in any central bank's gold holdings provided they came about through buying gold sold by another central bank attempting to deal with a balance of payments crisis.

Seidman passed on Schmidt's response: he had declined Ford's invitation to break with France; the FRG duly supported France in the Interim Committee.³³

June's Interim Committee meeting agreed in principle to gold being gradually phased out as a reserve asset, but set no deadline. The only specific measures it authorised were for the official price of gold to be abolished when the IMF *Articles* were revised and to permit central banks to sell gold to the private sector. There was no agreement on what should be done with the IMF's gold, or whether central banks should be permitted to buy private sector gold.

France had showed limited flexibility in the Interim Committee, changing its position slightly on IMF gold sales. Having previously been against the sales (so as to maximise France's gold receipts if and when the IMF returned its gold to the original depositors), France agreed with the majority (including the US) the IMF should sell some gold, using the proceeds to subsidise developing country borrowing from the IMF. No specifics were agreed, however; this remained an agreement in principal only. Meanwhile France continued to argue the remainder of the IMF's gold should be returned to the original depositors. Ford's concession, tempering the earlier US demand for national ceilings on gold holdings, cut no ice. The US remained internationally isolated on gold.

Concerns mounted in the Treasury and State Department. Enders had warned time was not on the US' side: the ground had been prepared for the IMF member states, at their Annual Meeting in September, to increase their national quotas at the IMF by one third, with slightly larger increases for OPEC states to give them a greater say in IMF affairs in recognition of their new economic power. Enders argued the US' negotiating leverage was maximised in the run up to the Annual Meeting because Washington could veto the quota increase others needed more than the US: Washington should seize this opportunity to advance its agenda on gold. Even so, Enders warned, the US would not get what it wanted on the IMF *Articles* unless it softened its hard line on gold.³⁴

Treasury and State Department arguments were water off a duck's back to Burns. Oblivious to time running out, he continued nit-picking on gold policy.

³³ Memorandum from the President's Assistant for Economic Affairs, Seidman, to President Ford, 10 June 1975; Rasmussen, *Foreign economic policy*, 298-99

³⁴ Confidential Memorandum from the Assistant Secretary of State for Economic and Business Affairs, Enders, to the President's Assistant for Economic Affairs, Seidman, 4 June 1975; Rasmussen, *Foreign economic policy*, 295-96

Simon's patience snapped on 28 August 1975.³⁵ He wrote to Ford asking for a decision on overall gold policy ahead of the Interim Committee's opening session in Washington on 31 August and the IMF Annual Meetings scheduled for the following week.³⁶ On Kissinger's advice, Ford sided with Simon in the EPB meeting on 29 August. This enabled Simon to offer a significant concession to France: he proposed the IMF would sell one sixth of its gold (25 m ounces) for the benefit of developing countries as the US wished, and a further one sixth would be returned to the original depositors, as France wished.

Kissinger advised Ford to write immediately to his "Big Five" peers to flag up the latest - now substantive - US concession.³⁷ Kissinger wanted Ford to claim credit for it as evidence of US leadership on IMF quotas and gold. Ford took his advice. Schmidt had dismissed Ford's previous "concession" on central bank gold trading; this time he and the other Big five leaders gave Ford a positive response and they supported Simon in the Interim Committee.³⁸ Ford thus secured a deal that all in the Foreign Economic Policy Executive except Burns thought was good for the US. The package included abolishing gold's official price and ending the obligation to use gold in transactions with the IMF, as well as a large quota increase (which would help the US' trading partners manage their balance of payments problems) and a change in IMF voting rules to enable the US to retain its IMF veto despite reducing its overall share of IMF quota.³⁹

³⁵ See for example (not classified) Memorandum from the Chairman of the Federal Reserve System Board of Governors, Burns, to President Ford, 28 August 1975; Rasmussen, Foreign economic policy, 317-19. Burns took issue with Simon about central banks being permitted to trade gold with each other at market prices.

³⁶ (Not classified) Memorandum from Treasury Secretary Simon to President Ford, 28 August 1975; Rasmussen, Foreign economic policy, 319-24

³⁷ The "Big Five" comprised France, FRG, Japan, UK and the US. An example of Ford's letter (addressed to Giscard) is attached to the (not classified) Memorandum from the President's Deputy Assistant for National Security Affairs, Scowcroft, to President Ford, 30 August 1975; Rasmussen, Foreign economic policy, 325-27. The letters were received in time to inform national positions at Interim Committee meeting in Washington on 31 August.

³⁸ The European recipients, Britain, France and the FRG, were already aware France was minded to be conciliatory. Fourcade told his EEC Finance Minister colleagues France would: no longer insist on the US losing its veto as a consequence of the IMF quota increase and redistribution; accept limited IMF gold sales aimed at helping developing countries; accept the US proposal for a global limit for central bank gold stocks, subject to central banks being able to buy and sell gold freely at market prices; and accept exchange rates being stabilised "by voluntary means outside the statutory framework of the IMF's Articles". (UKREP telegram to FCO no. 121 of 25 August 1975; UK National Archive file T354/385)

³⁹ The share of quota needed to veto proposals at the IMF was cut from 20% to 15%. This enabled the US to accommodate OPEC states' desire for larger quotas by ceding some of the US' quota share to them without sacrificing the US' veto over IMF decisions.

IMF member states agreed Simon's proposals at the Interim Committee meeting on 31 August 1975, but this US "success" was really a French victory. Moreover, the US concessions contradicted the impression some scholars gave that only France had to back down when amending the IMF's *Articles*.⁴⁰

Despite the US' best efforts, France had successfully defended a role for gold. The defence was not entirely successful. Gold's status in the IMF was much reduced by the abolition of both the official gold price and mandatory use of gold in IMF transactions; and the US "suspension" of gold convertibility had become permanent. But France had ensured the IMF would retain two thirds of its gold stock rather than selling it all; moreover, gold could still be used in IMF transactions if a member state wished. Central banks gained new freedoms to trade gold with each other and with the private sector at market prices. This ended gold reserves' "immobilisation". States could continue to use gold if they wished, and were incentivised to stockpile gold as a reserve asset. Many did so, regarding gold as an essential component of their reserves. The US had failed to demonetise gold in the new international monetary order. This demonstrated once again the limits to the US' positive structural power.⁴¹ France, backed by Europe, had wrung compromises out of Simon ensuring the SDR (over which the US had some control) never adequately replaced or rivalled gold (over which the US had no control).

The quotas and gold package agreed at the Interim Committee on 31 August deliberately excluded exchange rate rules. A G5 Finance Ministers meeting on the evening before the Interim Committee's meetings had agreed to delay resolution of the Franco-US exchange rate dispute until the next Interim Committee meeting, scheduled for Kingston, Jamaica, in January 1976.

Exchange Rate Rules

C20 Ministers agreed to legalise floating exchange rates in the amended IMF *Articles of Agreement* and to draw up a new code, *Guidelines for Floating*,

⁴⁰ For example, Eichengreen, *Globalizing capital*, 137-38

⁴¹ The G10 adopted the Burns/Wallich idea of a global ceiling on gold reserves, but this was meaningless: the rest of the IMF membership never accepted it and the G10 alone could not impose a downward trajectory on the amount of gold held by the world's central banks.

for use by all states floating their exchange rates. But the C20's agreement lacked specifics. It was unclear whether states could adopt floating only as a temporary departure from fixed exchange rates, or as a long-term policy.

The US and France held diametrically opposed positions on floating when the C20 negotiations concluded. Their discussions were subject to the same "trench warfare" as the disputed gold policy, but progress was slower. Neither the US nor France would give ground on what became a theological debate about the long-term structure of the international monetary order: was floating a temporary aberration, or an enduring feature of the new order?

The US' *laissez-faire* position was clear: states wishing to float their currencies should be free to do so: they should not be beholden to any IMF approval mechanism or be subject to international sanctions when adopting floating. The duration of floating should be for the state itself to decide.⁴²

The Shultz/Volcker failure in the C20 left a deep impression on the Treasury. Their successors, Simon and Bennett, were ideologically predisposed to allow market forces, not central banks, to set exchange rates.⁴³ They saw no purpose in the US pursuing an elusive - and in their eyes unworkable - fixed exchange rate-based international monetary order. They wanted to float the dollar on a long-term basis.

Unusually for an international monetary matter, Simon's and Bennett's cause was assisted by emerging domestic political pressures on the administration.⁴⁴ Congress had begun to favour floating the dollar by the time

⁴² Shultz had favoured floating exchange rates, but had pragmatically pursued a new order based on the fixed exchange rates Europe and Japan wanted. Volcker, despite being the US Treasury's main ideological champion of fixed exchange rates, was unable to design a viable fixed exchange rate scheme that could cope with OPEC's price increases; he began to doubt any fixed exchange rate system would be workable. Volcker told A. K. Rawlinson, British embassy, Washington, "A return to fixed parities was unsustainable in current circumstances..." (Rawlinson's Note for the Record, 29 November 1973; UK National Archive file T354/385) And Volcker became worried about more than exchange rates. Rawlinson reported Volcker saying he was "becoming more doubtful about the whole reform exercise." (British embassy Washington telegram 70 of 1 March 1974; Bank of England archive file OV53/76)

⁴³ Bennett, in "A Free dollar makes sense", argued "In the absence of a par value, there is less likelihood of (US) resort to extensive government borrowing abroad... I conclude it would be a serious mistake for the US government either to introduce a par value now or to promise to do so in the future. I would expect such action to lead to a less effective fight against inflation and thus more overall instability for the dollar."

⁴⁴ When discussing international monetary affairs with Kissinger and Shultz in March 1973, Nixon welcomed the freedom from domestic political pressures, telling his advisors "I think, except for the New York bankers and a few others, most people do not understand international (monetary policy) and couldn't care less... that's what Arthur (Burns) was

the C20 negotiations concluded.⁴⁵ Congress saw the issue in terms of power and prestige as well as international economics. It would not accept a reform requiring the US to seek IMF approval for its exchange rate policy: Congress was determined US exchange rate policy would be made by the US, not the IMF.⁴⁶ Having annoyed a large part of Congress by pardoning Nixon, Ford did not want to cross Congress again, unless absolutely necessary.⁴⁷ Business, agricultural and financial sector interests also supported continued floating.⁴⁸ Thus domestic political imperatives and the Ford administration's pro-market ideology converged: the US dropped its support for restoring a fixed exchange rate-based international monetary order.

Ford's Foreign Economic Policy Executive had a problem: the US' was unable to use hegemony by domination or hegemony by consensus to amend the IMF's *Articles* and legalise their policy of enduring dollar floating. Domination was impossible because other states possessed the negative structural power necessary to prevent the US imposing its wishes unilaterally, as had been demonstrated when Connally and Kissinger attempted to use domination to further US ends: Connally had been thwarted when Nixon needed to unite the Western alliance through the Smithsonian Agreement; and Kissinger's attempt to disrupt European integration had failed - the EEC's currency Snake experienced franc palpitations for a time, but it was very much alive and wriggling. Hegemony by consensus was equally unpromising: the

admitting, to his chagrin. He found, as he called (businessmen and economists) around the country, people weren't that stirred up about it." Nixon proposed to use his freedom from domestic political pressures to prioritise foreign policy and security interests over foreign economic policy when addressing the March 1973 crisis in the foreign exchange markets. (Conversation among President Nixon, Kissinger and Shultz, 3 March 1973; Rasmussen, Foreign economic policy, 72-91)

⁴⁵ A. K. Rawlinson produced a Note for the Record of his lunch with Congressman Reuss on 13 December 1973. He recorded Reuss as "strongly in favour of floating for the dollar", with Reuss claiming Shultz and (less credibly) Burns shared his views. Reuss also said that if other states wished to have fixed parities, they should be free to do so. (UK National Archive file T354/385)

⁴⁶ Simon reminded Ford that Congressman Reuss' had warned the administration must not ask Congress to approve revisions to the IMF *Articles* unless they provided for floating exchange rates to be fully legitimate and not subject to any licence from the IMF. Reuss, as chairman of the Subcommittee on International Exchange and Payments of the Joint Economic Committee, was well-informed about both international monetary reform discussions and the domestic political acceptability - or otherwise - of reform proposals. The administration could not afford to ignore him. (See Confidential Memorandum from Treasury Secretary Simon to President Ford, 3 June 1975; Rasmussen, Foreign economic policy, 290-96)

⁴⁷ Ford pardoned Nixon on 8 September 1974, a hugely controversial decision that soured Ford's relationship with Congress and resulted in his approval rating plummeting immediately from 71% to 50% according to Gallup Polls (Brinkley, Gerald R. Ford, 73).

⁴⁸ Discussed in chapter 7

majority of IMF member states favoured fixed exchange rates on ideological and national interest grounds.⁴⁹ Moreover, Watergate had compromised US hegemonic legitimacy and thus its leadership capacities: Washington needed time to rebuild the international trust Nixon had sacrificed.⁵⁰ Persuading other states to accept amendments to IMF's *Articles* aimed at introducing a comprehensive floating exchange rate-based order, or imposing this outcome using US structural power was impossible, notwithstanding structural Realist and Marxist scholars' claims to the contrary.⁵¹

With charm and brutality both seemingly ineffective as the basis for US foreign economic policy, the Foreign Economic Policy Executive was left with only one option: abdicate leadership, pursue the US' narrow national interest and admit other states should be free to do as they wished provided this did not include them imposing their collective will on the US. (The latter appeared unlikely: the US possessed sufficient negative structural power to block other states' attempts to impose unwelcome international structures on it.) Simon therefore adopted a minimalist approach to amending the IMF's exchange rate rules. He wanted *laissez-faire*: all states should be free to do as they wished; the new order should permit, but not require, states to float their currencies indefinitely. His hegemonic policy was to tell other states to do as they wished with their exchange rates, provided the US was allowed to do what it wanted.

France remained opposed, wanting to return to something close to the Bretton Woods par value system, combined with strong rules to discourage floating (the counterpart to Washington's demands for strong rules to inhibit central banks' use of gold). France believed each IMF member state should be obliged to agree set a fixed par value for its currency against the SDR and, through foreign exchange market intervention and/or capital controls, keep its

⁴⁹ EEC states wanted to retain their Snake arrangement; most developing countries wanted to fix their exchange rates and, acting collectively, either group could veto any proposed change to the IMF's *Articles of Agreement*.

⁵⁰ Ford recognised Watergate had undermined the US' capacity for leadership in 1974-75. In his speech accepting the 1976 Republican Party Convention nomination as their candidate in the presidential election, Ford admitted "the whole world watched and wondered where America was going. Did we in our domestic turmoil have the will, the stamina and the unity to stand up for freedom? Look at the record since August two years ago. Today America is at peace and seeks peace for all nations... The world now respects America's policy of peace through strength. The United States is again the confident leader of the free world." (Quoted by Perlstein, *Invisible bridge*, 798)

⁵¹ Discussed in chapter 7

currency's market value within a narrow range around par.⁵² Any deviation from a fixed exchange rate would require prior IMF approval. The IMF could authorise floating, but only in extraordinary circumstances and only temporarily.

Despite lengthy discussions, neither the US nor France was able to dislodge the other from its stance on exchange rates. As in the C20 negotiations, both states' policy positions were based on a coherent, self-sustaining economic logic, albeit mutually exclusive logics. And both states' visions of the future of the international monetary order appeared to be practical propositions, rooted in the economic realities of the moment. The US could point to most industrial states floating their currencies to help them cope with their current account adjustment and liberalised capital flow needs.⁵³ But when the US objected a fixed exchange rate system would be swamped by capital markets, as Bretton Woods had been, France could point to the EEC's Snake (which it had re-joined) as an example of a viable fixed exchange rate system co-existing with powerful financial markets and surviving OPEC's oil shock. Moreover, almost developing countries maintained a fixed exchange rate, pegging to the G10 currency of greatest significance to their economy.

The Franco-US exchange rate stalemate persisted from June 1974 to August 1975. The bickering was fierce at times.⁵⁴ Allies became "impatient" with the squabbling.⁵⁵ Finance Ministers in Britain, the FRG and Japan, exasperated beyond reason, threw in the towel in a G5 Finance Ministers meeting held on 30 August 1975. They agreed to accept any formula on

⁵² See French government's paper, written by Larosière, forwarded by J. P. Fourcade, Minister of Economy and Finance, to UK Chancellor Healey on 26 September 1974 (Bank of England archive file OV53/80)

⁵³ British Chancellor Healey assessed: "It would have been impossible for Britain to adjust to all the changes in the world economy during my period as Chancellor without the new international currency regime of floating exchange rates. The rest of the world found floating no less indispensable, if only because the impact of the oil price on inflation and the balance of payments differed so much from country to country" (Healey, *Time of my life*, 412).

⁵⁴ In May 1975 the British ambassador to France, Tomkins, reported French Economy and Finance Minister, Fourcade, told him France blamed the US for the failure of international monetary reform, saying there had been a "serious retrogression" in the US approach to gold and the future exchange rate regime since he had last met Simon in Washington and Martinique. Fourcade said he would be taking this up with Simon at their next meeting, at the OECD Council in June. Apparently Fourcade had been incensed by Simon calling publicly for the IMF's gold to be sold on private markets instead of being returned to the original depositors as France wished, and by Simon praising a floating rate regime instead of insisting on a return to a "fixed but adjustable exchange rate system." (British embassy Paris telegram 555 of 26 May 1975; UK National Archive file T354/385)

⁵⁵ Simon's description in his Confidential Memorandum to President Ford, 3 June 1975; Rasmussen, *Foreign economic policy*, 290-96

exchange rates that was mutually acceptable to France and the US. This was an extraordinary concession on their part, not least for what it tells us about the state of US hegemony and leadership at the time.⁵⁶ If, as I argue, hegemony is a status conferred on one state voluntarily by its followers, the willingness of three of the five main economic powers to nominate either the US or France as their monetary hegemon, and follow them, and the collective indifference as to whether that hegemon should be the US or France, demonstrates how low the US' post-Watergate, post-OPEC stock had fallen.⁵⁷

The French hegemonic vision for a new international monetary order was regarded by major states as being at least as credible as the US', but there would be no easy victory for France. British Chancellor Healey, bruised by the difficulty of achieving international agreement on gold, commented on France's problem: "Apart from the regrettable fact that in most situations every country would pursue its narrow national interests rather than seek a common international interest, no change could be made in the structure of international finance without the consent of the United States; and the United States would see no interest but its own, though its view of its interests might differ from person to person, or from administration to administration."⁵⁸ Healey had identified the main obstacle to French success: US negative structural power.

More encouragingly for Paris, Healey subsequently qualified his views based on his experience of persuading an unwilling Simon to agree to extend the temporary Witteveen Oil Facility.⁵⁹ Healey, having obtained unanimous EEC backing for his policy of replenishing and extending the Oil Facility,

⁵⁶ Rasmussen, *Foreign economic policy*, 328

⁵⁷ I discuss my definition of hegemony in chapter 2

⁵⁸ Healey, *Time of my life*, 416

Healey's comment on the difficulty of achieving international agreement on gold appears to have been a reference to the US attempt to persuade the G10 to accept a global limit on central banks' gold stocks. Healey wrote "In the end the most that we could agree on was that central banks should be free to buy and sell gold among themselves, providing they did not increase the total stock of gold in the world's official reserves. Even then we had the utmost difficulty in getting Washington to stick to the agreement." (*Ibid.*)

⁵⁹ The original Witteveen Oil Facility was part of the C20 agreement in June 1974: it was one element of the agreed increased resource transfers to developing countries. The Oil Facility's initial SDR3.2 bn funding was exhausted by the end of 1974; oil importing developing countries wanted industrial countries to replenish the Facility by borrowing from OPEC. Kissinger and Simon opposed this: they wanted to break the OPEC cartel and hoped divisions between oil importing and oil exporting developing countries would damage OPEC. Kissinger and Simon wanted to allow time for intra-developing country problems to fester and meanwhile create an OECD "Support Fund" to assist industrial countries. EEC states preferred to extend the Oil Facility and opposed the US Support Fund proposal.

persuaded the US to accept it after tough negotiations with Simon, Burns and Kissinger. Healey commented:

“I drew another lesson from this episode. I had already learned it is almost impossible to get anything done through an international body without American agreement. But now I knew that it may be possible for the Europeans to secure a change in a fixed American position, provided they are united, determined and well-briefed. That is as true in the diplomatic field as I have personally shown it to be in the fields of defence and economics.”⁶⁰

Expressed in different terminology, Healey's remarks pointed to the US possessing - and deploying - substantial negative structural power, but the EEC could, when united, overcome it with its own positive structural power.

Healey's Oil Facility example helps shed light on the profound weaknesses in France's bargaining position in the exchange rate rules dispute with the US. Paris faced three noteworthy problems. First - and probably foremost - Britain and Italy favoured floating exchange rates so France lacked the EEC's united backing, which Healey identified as essential if Europe were to win an argument with the US. Second, there were tensions between the Snake-participating states, notably Franco-German disparities in economic performance. These tensions caused foreign exchange markets to doubt the sustainability of the franc's Snake membership: France, never the FRG, had to intervene in foreign exchange markets to maintain the franc's value within the Snake, evidence of significant weaknesses in France's economic power. And third, France was the *demandeur* in the exchange rate order argument.⁶¹ The

⁶⁰ Healey, *Time of my life*, 426. The Witteveen Oil Facility was replenished with \$6 bn. Simon agreed to this on condition EEC states supported US efforts to create the OECD Support Fund, which they did. The Support Fund was never created, however, because Congress refused to ratify it.

⁶¹ See Yeo's comment during a preparatory meeting for the Economic Summit at Rambouillet: "The Germans have an IOU to the French on the Snake. The French are doing all the intervening. Schmidt is attempting to honour that IOU (by supporting Giscard on the choice of the future exchange rate system)." (Confidential Memorandum of Conversation, 6 November 1975; Rasmussen, *Foreign economic policy*, 357-62) Edwin Yeo had replaced Jack Bennett as the Treasury's Under Secretary for Monetary Affairs in 1975 when the latter, an oil man by background, resigned to return to Exxon. Personalities can make a difference in diplomacy. Bennett "refused to agree a new set of rules requiring a par value for the dollar" in discussions with the Europeans (Odell, *International monetary policy*, 329). And he delighted in provoking the Europeans as he did so, as Bank of England and UK Treasury officials had observed with

US had been the *demandeur* on gold in wanting to impose new restrictions on its use, enabling France and other states to take defensive, blocking negotiating positions without shifting their initial policy positions. The situation was reversed on the question of whether to permit long-term floating in the new exchange rate order. France wanted to recreate an international monetary order that had failed in 1971, collapsed comprehensively in 1973 and which C20 Ministers had been unable to reconstitute in June 1974. The US, by contrast, was able to defend a floating rate order that had become a satisfactory *status quo* for many states after March 1973.

A French success on exchange rates would have required it to overwhelm the US' defence of a floating rate order that was palpably working in the interests of many states, including Canada, Italy, Japan and the UK. France, leading a divided EEC, could not muster the positive structural power needed to achieve its highly complex exchange rate objective whereas, as Healey observed, the US possessed ample negative structural power to defend a single, simple objective: continued floating.

Rambouillet Economic Summit

The exchange rate question was resolved eventually through a French concession. This reflected Paris' and Washington's willingness to resolve their theological differences over the international monetary order's design through compromise at the Rambouillet Economic Summit in November 1975. Giscard conceded to the US what was domestically politically important to Ford (floating exchange rates), just as Ford had earlier conceded to France what was domestically politically important to Giscard (gold's role). It was not obvious at the time such a compromise would be possible.

distaste in OECD WP3 meetings (see Secret minute from C. W. (Kit) McMahon to the Governors, "International Monetary Reform After the Recent Upheavals", 28 February 1973; Bank of England archive file OV53/69, discussed in chapter 6). Bennett's resignation was seen as removing an irritant in US-European relations. Winston Lord, Director of Policy Planning Staff in the Department of State, briefed Kissinger in a *Memorandum on International Disagreements on Economic and Monetary Issues* on 3 July 1975; he commented "Jack Bennett's resignation from the Treasury should help clear the atmosphere and make agreement more likely" (Rasmussen, *Foreign economic policy*, 310-13).

The process by which this compromise was achieved is worth examining for what it tells us about the precariousness of US monetary hegemony in 1975 and the extent to which scholars' claims of effective US structural power were exaggerated.⁶² Archived records reveal the Ford administration was uncertain it would prevail on exchange rates, even on the eve of victory. There is no evidence in US or British archives of the US using its structural power to sweep aside lesser states and rewrite the international monetary order's rules unilaterally to its own advantage, nor does one find the cynical US Sterling-Folker described, a US prepared to co-operate with other states during a crisis, but reverting to selfish national interests once the crisis passes.⁶³ Instead one finds Washington's policymakers and senior officials divided, worried by the prospect of the French pulling the wool over their President's eyes or of a Rambouillet ambush in which Europe's two wildest former Finance Ministers, both now leading their states, would outsmart the US' relatively new, diplomatically naïve, president. The archives tell us a great deal about the nature of US power and hegemony, much more than can be gleaned by accepting some scholars' theory-based versions of events.

The tortuous process of ending the Franco-US *impasse* over exchange rate rules began in Martinique in December 1974. OPEC's oil price increase had pushed the industrialised world into deep recession, precipitating high unemployment.⁶⁴ The West's response was confused. Ford decided tackling inflation would be his best route to US economic recovery.⁶⁵ European leaders were split: Schmidt, like Ford, prioritised inflation reduction; Giscard, Moro and Wilson were more concerned about rising unemployment, but tackling it with Keynesian spending policies was complicated because their economies were already over-spending. Japan, completely dependent on imported energy, prioritised its balance of payments. So the US and its major allies were in

⁶² One searches in the archives in vain for the powerful hegemon featuring in some of the academic literature, including Gowan, *Global gamble*, Kunz, *Butter and guns*, Strange, *Casino capitalism*, Seabrooke, *US power in international finance*, and Walter, *World power and world money*.

⁶³ Sterling-Folker, *Theories of international co-operation*, 214

⁶⁴ The recession was the deepest since the Great Depression of the 1930s. The West's excessive spending produced high rates of inflation combined with large external deficits. The US' economic performance at the time was typical of its industrial country peers: real GDP declined 0.6% and civilian unemployment rose to 5.6% in 1974; inflation was 11% when Ford took office and the trade deficit \$5.5bn in 1974, then the second largest deficit in US history.

⁶⁵ For an account of Ford's anti-inflation policy, see Greenspan, *Age of turbulence*, 65-74.

disarray when Ford and Giscard met for their bilateral Summit on Martinique on 15 December. Giscard, pondering the question of policy co-ordination and international economic governance, shared his views with Ford:

“The Group of 20 failed. We need a new approach. The G5 risks offending EEC partners. If needed, we (France) could take the initiative for a meeting to organise co-ordination for dealing with economic problems.”⁶⁶

Nothing was agreed at the time, but the possibility of France hosting an economic summit remained in Giscard’s mind.⁶⁷

The idea resurfaced six months later when Giscard met the US ambassador to France, Kenneth Rush, at a reception in Paris on 25 June 1975. Seizing the moment, Giscard ushered Rush into a separate room for a private conversation. Giscard told Rush French unemployment was approaching one million; he feared the political consequence. High unemployment might precipitate a repeat of 1968’s revolutionary events or, at a minimum, the communists and socialist parties would prosper in the 1976 national elections. Giscard promised to instruct his advisers to contact Washington to discuss joint US-European action to tackle the West’s economic problems. Hinting at a French concession, Giscard told Rush “both the French and the Americans could have shown more flexibility on monetary issues”; Giscard promised his government would soon contact Washington with a “new proposal”.⁶⁸

Giscard believed the solution to French economic problems was linked to the international monetary system. The dollar had depreciated since March 1973; a competitive dollar exchange rate was preventing France - and other Snake member states - from climbing out of recession by pursuing export-led growth. What Giscard wanted, as Simon eventually grasped, was a return to a pre-August 1971 world in which the dollar would be locked into an overvalued

⁶⁶ Secret Memorandum of Conversation, Martinique, 15 December 1974; Rasmussen, Foreign economic policy, 275-77

⁶⁷ The idea for Western leaders to convene an economic summit had been around for years. Nixon discussed it with Japan’s Prime Minister Sato when they met in San Clemente on 6-7 January 1972, where they agreed “the Great Economic Powers - US, Japan, Germany, Britain, France, plus possibly Italy and Canada - should develop a consultation procedure in which they would discuss how they could build a ‘productive Free World economy’ with trade and monetary stability.” (Duncombe, Foreign economic policy, 216)

⁶⁸ Secret telegram from the US embassy in France to the Department of State, 25 June 1975; Rasmussen, Foreign economic policy, 300-01

rate in a fixed exchange rate system, enabling French and other European exporters to prosper in world and US markets.⁶⁹

Giscard's "new proposal" emerged in July ahead of a Quadripartite (G4) lunch attended by Ford, Giscard, Schmidt and Wilson in Helsinki on 31 July.⁷⁰ Giscard proposed to host a small Economic Summit, attended by G5 leaders only. Giscard hoped they would take the political decisions necessary to create a new Bretton Woods-style regime and reflate the West's economies. Simon advised Ford to reject the proposal, fearing Ford would find himself in a minority defending his anti-inflation macroeconomic policies, while the others pressed him to reflate the US economy so they could export more to it.⁷¹

Schmidt, like Giscard, had national economic problems uppermost in his mind in summer 1975. At a bilateral Summit in Bonn on 27 July he warned Ford the West's ailing economy, not the Soviet Union or Italian communism, was the greatest threat to the Western alliance. Schmidt, not for the first time, appealed to Ford to show leadership and accept Giscard's proposal.⁷² Schmidt's enthusiasm for Giscard's proposal appeared to justify Simon's fears of European motives because Schmidt told Ford:

"The leadership should be by the United States. Your strong leadership is needed, without appearing to do so... The economic leaders in the US - Simon, Greenspan and, regrettably, Burns - look too much to domestic problems and not to world effects."⁷³

In a breath-taking display of parochialism and illogical economics, Schmidt then complained the dollar's value was too low against the deutschemark, while high US interest rates were sucking capital out of the FRG economy. This, in

⁶⁹ (Not classified) Memorandum from Treasury Secretary Simon to President Ford, 26 July 1975; Rasmussen, Foreign economic policy, 303-04

⁷⁰ The leaders were attending the Helsinki Summit convened to sign the Final Act, the treaty concluding the protracted Conference on Security and Co-operation in Europe (CSCE).

⁷¹ Ford's policy had halved US inflation from when he took office to 6% in June 1975 and, although unemployment had increased from 5½% to 9% during the same period, US economic growth had resumed (Not classified) Memorandum from Treasury Secretary Simon to President Ford, 26 July 1975; Rasmussen, Foreign economic policy, 303-04).

⁷² Secret Memorandum of Conversation, Bonn, 27 July 1975 (Rasmussen, Foreign economic policy, 305-11) contains a record of the Ford/Schmidt discussions at their bilateral Summit. Schmidt's earlier appeal to the US to demonstrate economic leadership can be found at Rasmussen, Foreign economic policy, 301.

⁷³ Ibid., 305-11

Schmidt's view, was delaying a German economic recovery because the FRG could neither export nor invest.

Ford wrong-footed Schmidt by agreeing to the Summit instantly, suggesting each participating state nominate a senior official to prepare it. Ford had even come ready with a name: George Shultz would be the US representative (later known as "sherpa").⁷⁴ Schmidt, unprepared, floundered in the discussion. But Ford wanted a successful Summit and was prepared to work for it. He made his reasons clear, telling Schmidt

"...we must integrate our (i.e. Western) thinking and actions, both because of the political situation in Europe and in the United States...We have an election next year and want to enhance the economic improvement in the months ahead. I think we can concert our policies."⁷⁵

After Schmidt's bleating about Ford's anti-inflation policy being tougher than his, this sounded as much a threat as a promise!

Schmidt, constructive after Ford's positive response on the Economic Summit, tried to resolve the Franco-US exchange rate squabble by proposing a timetable. At the Quadripartite lunch in Helsinki (held four days after the Schmidt/Ford bilateral meeting) Schmidt circulated a secret, private paper to Ford, Giscard and Wilson setting out his views on what they needed to do, which included his comment

"I do not believe that the United States and France will reach agreement quickly on a future exchange rate system. We should not attempt to find a solution at the IMF Annual Assembly (sic). It should be held back for the planned economic summit conference."⁷⁶

⁷⁴ On leaving the Treasury, Shultz was recruited by Bechtel as its president.

⁷⁵ Secret Memorandum of Conversation, Bonn, 27 July 1975; Rasmussen, Foreign economic policy, 305-11

⁷⁶ Secret Memorandum by Chancellor Schmidt: Private Memorandum on International Concertation of Action, Helsinki, 31 July 1975; Rasmussen, Foreign economic policy, 312-14. The "IMF Annual Assembly" was held in Washington in the first week of September; the Economic Summit was held in Rambouillet on 15-17 November 1975.

This was prescient: exchange rate policy was to be one of the main items - the most important according to Kissinger - on the Economic Summit's agenda.⁷⁷

Ford held a bilateral meeting with Japan's Prime Minister Takeo Miki in Washington on 5 August, shortly after the Helsinki lunch. Ford encouraged his guest to participate in the Economic Summit, while explaining his own reasons for doing so: "Our economic picture is improving, but we can't do it (generate a Western recovery) alone...Our situation looks good, but we can't go it alone."⁷⁸ He went on to make explicit the conditionality implicit in his earlier remarks to Schmidt in Bonn, telling Miki he would agree to the Economic Summit only if there were prior agreements on issues, explaining: "It would be disastrous if we entered negotiations at the Summit with disagreements among us. We should agree in advance to co-ordinate views...if there are disagreements, we could not hold (the Summit)."⁷⁹

Ford's "no disagreements" prior condition was a smart move. Word of it soon reached the other Summit participants. Giscard wanted his Summit to be a success, not threatened by US cancellation. He intended to use the Summit to bolster his personal prestige in France, boost his national and international reputation as a statesman, and enhance his political capital before his government faced national elections in early 1976. Ford's prior condition potentially jeopardised this. Perhaps not coincidentally, the French approach to the exchange rate argument appeared to shift from this point onwards: some officials, including the French sherpa Barre, continued to argue dogmatically in favour of the new international monetary order being based on fixed exchange rates; others, however, including Larosière, worked increasingly constructively with US representatives, encouraging Washington to hope agreement might be found with a little more time and effort. The French tactical ambiguity made it difficult for Washington to pull the plug on Summit preparations, while leaving Washington uncertain about which French position was the bluff.

⁷⁷ Kissinger briefed the US media on the flight back to Washington after the Economic Summit at Rambouillet. He told them the Franco-US agreement on international monetary affairs was "perhaps the single most significant thing that happened there" (Rasmussen, *Foreign economic policy*, 452).

⁷⁸ Rasmussen, *Foreign economic policy*, 315

⁷⁹ *Ibid.* Ford had told the EPB the previous day "If we recover and Europe's economies don't, we could be in big trouble." Rasmussen, *Foreign economic policy*, 314

Achieving a widely-recognised success would be difficult for Giscard because “success” meant different things to different people. For Italy’s Prime Minister Alberto Moro, simply to be included in the Summit counted as success. Japan’s Miki was similarly minded: success for him meant participating in the Summit and warding off any threats to Japan’s mercantilist trade policies.⁸⁰ Other participating leaders wanted to use the Summit as a unique forum for a frank exchange of views, hoping to identify opportunities for policy co-operation and co-ordination and thereby achieve economic gains for their electorates. For these electorates, however, “success” would require the leaders to produce something tangible, not promises of future closer co-operation, but concrete agreement on at least one specific policy. That concrete achievement turned out to be the US-French deal on exchange rates because, for the first time since March 1973, the Franco-US exchange rate disagreement was seen by Paris as an obstacle to Giscard obtaining something he prioritised: the political capital and prestige he would gain by hosting a successful Economic Summit.

Either Schmidt’s suggested timetable for the exchange rate discussions or Ford’s implicit threat of the Economic Summit being cancelled (or both) had the desired effect. Franco-US squabbling over exchange rates was set aside at the IMF meetings in Washington in September, enabling the Interim Committee to concentrate on agreeing the IMF quota increase and gold policy when it met on 31 August 1975. Ford’s proposal for each Economic Summit participant to nominate a sherpa to help prepare the Summit was accepted. Shultz was soon discussing exchange rate philosophy - robustly - in meetings with sherpa colleagues.⁸¹ His main sparring partner on monetary issues was Raymond Barre, then a member of the Banque de France’s General Council.

Shultz and Barre soon exhausted their colleagues’ patience. Shultz took a hard line in defending the US position on floating against Barre’s arguments, at one point impressing on his sherpa peers the US would not accept a

⁸⁰ Other than leading the discussion in the session devoted to trade issues, Miki contributed little in Rambouillet, pretending to doze through most of them. At one point in the Summit, goaded by an extended period of Japanese inertia, Simon passed Kissinger a note: “I think Miki has just died!” (Kissinger, *Years of renewal*, 695)

⁸¹ These soon included an Italian sherpa, reflecting the wishes of European participating states. Canada did not participate, despite British and US efforts to secure it an invitation to the Summit. Giscard consistently vetoed Ford’s repeated efforts to include the US’ main trading partner, which coincidentally also happened to be a state committed to permanently floating its currency.

commitment to adopt fixed exchange rates, not even as an “ultimate aim” in the new international monetary order. Barre would accept nothing less. They generated more heat than light. The other sherpas agreed progress depended on avoiding exchange rate theology and the consequent disagreement over fixed and floating rates.⁸² As the sherpas attended to other issues, discussion of exchange rates was taken up elsewhere.

With Shultz safeguarding the US position on exchange rates in the sherpas group, the US launched a diplomatic initiative through Edwin Yeo, Bennett’s emollient replacement as Treasury Under Secretary for Monetary Affairs. Yeo was sent on a tour of the main European capitals in October to argue the US’ case on exchange rates.

Yeo’s first call was in Paris, on Jacques de Larosière, then Director of the Trésor, and Bernard Clappier, Governor of the Banque de France, two economic technocrats. Yeo explained Washington’s view and concluded “the balance of power had shifted (towards markets and) against officials”.⁸³ Larosière could not have been more encouraging, telling Yeo he agreed fully with the US views: markets could “swamp” any government efforts to set exchange rates. France, he said, was looking “to co-ordinate and co-operate on (foreign exchange market) intervention”; the French objective was simply to deal with “extreme fluctuations”. To this end, France would welcome US agreement to include “stability” as one of its objectives for international monetary reform and require the IMF to monitor states’ efforts to create stability.⁸⁴ Stunned by this apparent French *volte face*, redefining stability in terms of structures rather than exchange rates, Yeo agreed to Larosière’s request that he reschedule his agenda, return to Paris after completing his visits to Bonn and London, and prepare “Outline language that would settle the

⁸² Shultz’s performance in the sherpas group is described in a Secret Memorandum from the Counsellor of the Department of State, Helmut Sonnenfeldt, to Secretary of State Kissinger, 8 October 1975; Rasmussen, Foreign economic policy, 332-36

⁸³ Yeo argued exchange rate instability was confined largely to the dollar’s exchange rates against Snake currencies; it reflected disparities in their inflation rates and their real economic performances; it was fuelled by large volumes of short-term capital that had been created as a result of the need to recycle OPEC current account surpluses; and the volumes of capital were so large they had overtaken governments’ abilities to determine exchange rates. The Yeo/Larosière meeting is reported in a Secret telegram from the US embassy Paris, to Department of State, 12 October 1975; Rasmussen, Foreign economic policy, 340-42.

⁸⁴ Ibid.

exchange rate question in terms of the IMF *Articles*".⁸⁵ In his reporting telegram Yeo said he "sensed" the French wanted agreement on the text before the Economic Summit.

Yeo returned to Paris before the end of his visit to Europe and agreed with Larosière what proved to be the first of three draft Memoranda of Understanding on Exchange Rates (MoU).⁸⁶

Did the draft MoU represent a settled French policy? Was it a bluff? Would Giscard welcome this agreement or revert to France's hard line on fixed exchange rates at the Economic Summit? Yeo was further perplexed when, in a meeting with the German sherpa, Poehl, in Bonn, his host greeted him with a German proposal that leaders agree at the Economic Summit to maintain their currencies within "zones" - wide bands either side of an agreed central or par rate.⁸⁷ Once a currency came under pressure to break out of its zone, upwards or downwards, the German proposal was equivalent to managing a currency in a fixed rate system. A currency approaching the limits of its zone could be regarded as experiencing the "extreme fluctuations" Larosière claimed was the French concern. It appeared the pro-EEC Schmidt was supporting France against the US. Poehl's proposal created fears in Washington of a Franco-German trap for Ford, luring him into accepting the fixed rate system Giscard wanted rather than the infrequent, stabilising foreign exchange market interventions Larosière appeared to propose.

Uncertain about Giscard's and Schmidt's intentions, Ford's advisers fretted in the lead up to the Economic Summit. Despite the huge diplomatic assets at Washington's disposal, US policymakers were unable to discern Giscard's intentions. The uncertainty fed a hostile, defensive attitude in some officials. Simon even resuscitated the Nixon/Kissinger plan to divide the

⁸⁵ Ibid.

⁸⁶ Ibid., 342

⁸⁷ Yeo travelled from Paris to Bonn, where Poehl, the FRG's sherpa, said he expected Giscard's Summit presentation on exchange rates to blame Europe's current economic problems on exchange rate instability; Poehl predicted Giscard would call for states to stabilise their currencies within wide exchange rate bands or "zones". Suspiciously well-prepared to comment on Giscard's possible exchange rate initiative, Poehl said the deutschemark's "zone" would be DM2.50-2.70 to the dollar. (This echoed ideas published by Otmar Emminger on 26 August, which included the suggestion the deutschemark be kept in a range of DM2.40-2.60 to the dollar in order to defend FRG competitiveness while avoiding imported inflation.) The Yeo/Poehl meeting is reported in a Confidential Telegram from the US embassy in Bonn to the Department of State, 14 October 1975; Rasmussen, Foreign economic policy, 344-46

Europeans by wrecking the Snake.⁸⁸ Puzzled and nervous, Yeo was sent back to Paris to discuss the draft MoU, while officials in Washington formed a consensus around Robert Hormats' formula in his *Summit Strategy Paper*: "as long as the US is not denied the option to float", the president should agree to examine any other policy option that would reduce instability.⁸⁹

The final sherpas meeting was held in London on 12 November; its outcome did nothing to calm Washington's nerves. Shultz reported Barre was prepared to offer substantive compromises on several disputed issues, but nothing on exchange rates. Moreover, Shultz found Poehl "consistently unhelpful". Sherpas were able to agree only "tentative" wording on exchange rates in the draft communiqué they prepared for their leaders to issue at the end of the Economic Summit.⁹⁰ The prospect of a Franco-German stitch up on exchange rates at the Summit was very real in US officials' minds.

Nerves were frayed. On reading Shultz's report of the final sherpas meeting, Helmut Sonnenfeldt, Counsellor to the Department of State, was pessimistic: "It is questionable whether we can get our language on trade, energy and money (in the final communiqué)".⁹¹ In his memorandum to the Secretary of State - his boss - Sonnenfeldt launched into a personal attack on Kissinger, both for putting the US in "an unnecessarily combative position" and President Ford in "an unnecessarily controversial position" on the Summit.⁹² Sonnenfeldt criticised Kissinger for going "too far, too fast" in the Summit preparations when "there is no doubt that all the senior people (in the administration) remain opposed to the Summit". Sonnenfeldt forecast "the press is going to pronounce the Summit as either a failure or a waste of time (so) it is easy to see where all the 'blame' will be put."⁹³ He meant the US in general and the president in particular.

⁸⁸ Simon claimed "If we hang on (i.e. not agree on exchange rates at the Economic Summit), we can split them (the French) off again." See Confidential Memorandum of Conversation, 6 November 1975; Rasmussen, Foreign economic policy, 357-62

⁸⁹ Secret Memorandum from Robert Hormats, National Security Council staff, to Secretary of State Kissinger, 24 October 1975; Rasmussen, Foreign economic policy, 349-55. Yeo travelled to Paris 10 November, shortly ahead of the Economic Summit.

⁹⁰ Secret Telegram from the US embassy in London to the Department of State, 12 November 1975; Rasmussen, Foreign economic policy, 373-76

⁹¹ Confidential "Eyes Only" Memorandum from the Counsellor of the Department of State, Sonnenfeldt, to the Secretary of State, Kissinger, 12 November 1975; Rasmussen, Foreign economic policy, 372-73

⁹² Ibid.

⁹³ Ibid.

US officials feared the worst for Rambouillet. The Giscard-led session on exchange rates appeared especially dangerous for US interests. Giscard and Schmidt had been highly successful Finance Ministers; both had first-hand experience of dollar-precipitated exchange rates crises. They were now united in promoting European integration, including its fixed exchange rate Snake. Judging from Poehl's remarks to Yeo, France and the FRG appeared to have concocted a new version of a fixed exchange rate regime, based on defending exchange rates within broad "zones". Barre had given no indication in sherpa meetings France would accommodate the US on exchange rates. US officials feared the inexperienced Ford would be unable to win theological arguments about exchange rates with the dangerous, mutually-supporting Giscard and Schmidt. They therefore briefed Ford not to engage in substantive discussion in the session devoted to exchange rates and to insist the matter be delegated to Finance Ministers.⁹⁴ This defensive, fearful US was nothing like Strange's description of a US using its structural power to prevail over its allies!⁹⁵

Washington need not have worried. The Economic Summit discussions were organised around a number of topics, including "Monetary Issues". A different leader introduced each topic, followed by a general discussion. Giscard led on Monetary Issues. He criticised floating exchange rates for "creating instability" and a "source of disorder" in his introductory remarks; he invited leaders to consider what a stable system would look like and appeared to challenge his colleagues:

"We could, in my view, set up a more stable monetary system...Some say conditions are not right for such a system...I know the US position. Would it not be more striking for us to reach agreement here? ...to attempt to bring order to the international monetary system?"⁹⁶

⁹⁴ (Not classified) Memorandum from Secretary of State, Kissinger, Treasury Secretary, Simon, the President's Assistant for National Security Affairs, Scowcroft, and the President's Assistant for Economic Affairs, Seidman to President Ford, 12 November 1975; Rasmussen, Foreign economic policy, 378-85. Note that Finance Ministers, along with Foreign Ministers, accompanied their national leaders to the Summit and held separate meetings with their respective peers during the Summit.

⁹⁵ Strange, *Casino Capitalism*

⁹⁶ Secret Memorandum of Conversation at Rambouillet, 16 November 1975; Rasmussen, Foreign economic policy, 400-19

This was just bluster. Giscard's only specific proposal was for central banks to promote stability by sharing information. There was no sign of the exchange rate "zone" proposal Washington feared. Giscard had already secured Ford's concessions on new rules for gold. These were politically vital in France; their adoption by the IMF's membership was still fresh in the mind.⁹⁷ Ford's acceptance of what Giscard needed on gold doubtless helped pave the way for Ford to get from Giscard what he needed on exchange rates at Rambouillet.

Despite the earlier omens, Schmidt caused no trouble for Ford. He said he wanted fixed parities to be the "ultimate aim" of reform, but recognised they could not be achieved now. Instead, he argued:

"we should agree in Jamaica a *modus vivendi*...Just state what we are doing and end the struggle on theology. Let's get that out of the way... we should agree here and stop the discussions."⁹⁸

Wilson too was impatient - as his "I wish these two young people could get along" joke made clear - and called for leaders to instruct their Finance Ministers to settle now and bring their results to the G10 meeting in Paris on 19 December. Miki agreed. Moro was enigmatic: "We need discipline to deal with exchange rate fluctuations, but also flexibility in present circumstances."

Ford alluded to the fruitful Yeo/Larosière bilateral economic diplomacy:

"We all share the broad objective of exchange rate stability, but we all agree a system of (fixed exchange rates) could not be viable at the present time. I would further state the US and France have reviewed these issues and we have resolved our differences on exchange rate matters... The international exchange rate system that is adopted must permit each country to choose the exchange rate regime that will permit it best to pursue its desired growth, employment and stability policies while

⁹⁷ The US concessions to France on gold's role in the new international monetary order were agreed in principle by participants in the IMF Interim Committee meeting in August 1975, and endorsed by all IMF member states at their Annual Meeting in late September, i.e. less than two months before the Rambouillet Summit.

⁹⁸ Secret Memorandum of Conversation at Rambouillet, 16 November 1975; Rasmussen, Foreign economic policy, 400-19

meeting its obligations to other countries to avoid trade and co-operation restrictions and other beggar-thy-neighbour practices.”⁹⁹

Ford concluded by asking Finance Ministers to finalise their agreement “tomorrow”, adding “...no regime that runs counter to market realities could remain in effect for long...present arrangements are working well.”¹⁰⁰

Simon and Fourcade initialled a US-France MoU on exchange rates the following day, the outcome of Yeo’s and Larosière’s efforts. The US and France jointly lobbied for its acceptance by other states, with France approaching one half of the G10, the US the other half and the IMF. Edwin Truman, a Federal Reserve Board member of staff, recorded the MoU was well-received, except in the IMF where Managing Director Witteveen and his General Counsel, Gould, were unhappy with it, but were told by the US and France they could not alter its wording.¹⁰¹

From Rambouillet to Jamaica

G10 Deputies agreed Rambouillet’s exchange rate MoU at a meeting in Paris on 11-12 December; G10 Ministers and central bank governors approved it at their meeting in Paris on 19 December. This agreement fed into the IMF Interim Committee meeting held in Kingston, Jamaica on 7-8 January 1976. Simon reported triumphantly to Ford:

“I am pleased to report that at Jamaica last week the IMF Interim Committee reached agreement on a major reform of the international monetary system...We concluded the first sweeping revision of our international monetary arrangements ...since 1944... As a result we now have a flexible monetary system

⁹⁹ Ibid.

¹⁰⁰ Ibid. “Tomorrow” was a reference to 17 November 1975, the Economic Summit’s third and final day.

¹⁰¹ Strictly Confidential Notes, drafted by Federal Reserve Board staff member, Edwin Truman, on an International Monetary Group Meeting, Washington, 5 December 1975; Rasmussen, Foreign economic policy, 452-54

which can adapt to changing international circumstances, avoiding the strains and stresses of the 1960s..."¹⁰²

The Interim Committee agreement encompassed quota increases, new resource transfers to developing countries and new rules for gold and exchange rates. The Franco-US exchange rate dispute was resolved by inserting a small revision in Article IV of the IMF's *Articles of Agreement*, the relevant part of which reads "under an international monetary system of the kind prevailing on 1 January 1976, exchange rate arrangements may include... (iii) other exchange rate arrangements of a member's choice."

France had failed in its attempt to restore a fixed exchange rate order, but the door to future change was left ajar. As a sop to France, the *Articles* were amended to permit the restoration of a fixed exchange rate order subject to 85% of IMF members' votes approving such a move. This meant little, however, because the US retained its veto in the IMF. If the US were opposed, a return to a comprehensive fixed exchange rate order was impossible.

The US had given no ground in the negotiations on exchange rates, but had been obliged to make concessions to France on gold and to industrial countries in general on the distribution of IMF quotas to reach overall agreement on the measures adopted in Jamaica.¹⁰³ The US used its negative structural power to achieve its objectives by blocking French efforts to restore a fixed exchange order. Had the US tried to achieve something novel, contentious or more ambitious than simply defending the *status quo* on floating, it might have failed at Kingston as it did in the C20 negotiations. As we have seen, the US under Nixon and Ford lacked the positive structural power needed to overcome determined and united European opposition.

Like the agreement on gold, the exchange rate agreement was permissive rather than prescriptive, leaving the new order to evolve. The US was criticised for producing a "non-system", but this was too harsh. The new

¹⁰² (Not classified) Memorandum from Treasury Secretary Simon to President Ford, 13 January 1976; Rasmussen, Foreign economic policy, 457-60

¹⁰³ The US had wanted all industrial countries to reduce their share of IMF quotas proportionately to create room to increase oil exporting developing countries' shares, but other industrial countries - fearing they would need to borrow from the IMF and knowing the amount they could borrow depended on the size of their quota - refused to accept this. The US was forced to take a bigger cut in its quota than it had originally intended to secure agreement, hence the need to modify the IMF's rules on voting to maintain the US' veto.

arrangements constituted an order.¹⁰⁴ And it did evolve. Regime-building to support free capital mobility was already underway by 1976, albeit in forms unfamiliar to those used to thinking of regimes in terms of, say, Bretton Woods or NATO. The new regime was more technocratic, informal, specialised and fragmented, covering various issue-specific aspects of international finance.¹⁰⁵ Contrary to Sterling-Folker's argument about the US withdrawing from international co-operation once crises had passed, the US did not turn its back on international financial co-operation once the world economy had accustomed itself to floating exchange rates. Indeed, the US worked hard to broaden and deepen co-operation between financial regulators in all financial markets.¹⁰⁶

The US possessed a relatively flexible, dynamic and innovative economy. It was able to build on its comparative advantage in financial services: US financial institutions moved quickly to adapt to the new circumstances. Floating exchange rates and free capital mobility thus played into US economic power better than most people had expected at the time, and arguably better than even Simon appreciated either then or later.¹⁰⁷ One searches his autobiography in vain for any reference to his part in the

¹⁰⁴ For example, Williamson argued the failure of international monetary reform during 1969-76 had created a "non-system" (Williamson, *Failure of world monetary reform*, 75). Slaughter, in "Governing the global economy", observed the Bretton Woods regime's collapse was followed by new, issue-specific approaches to regime-creation in the financial sector.

¹⁰⁵ The Bank for International Settlements had, at the G10's request, been monitoring the Eurodollar market through its Eurocurrency Standing Committee since 1971. Its efforts were upgraded in 1974 when the G10, plus Luxembourg, created the Basel Committee on Banking Regulations and Supervisory Practices in 1974, later renamed the Basel Committee on Banking Supervision. The need for it to contribute to regime building soon became apparent as some banks struggled to cope with the challenges of managing free capital mobility and floating exchange rates. There were early bank failures, including Bankhaus Herstatt, the FRG's largest private bank, and Franklin National Bank, the US' 20th largest bank, both in 1974. The Basel Committee embarked on the task that has grown ever more complex since of defining the rules national regulators should use when supervising banks as well as identifying the regulators' own responsibilities. This and other specialist regimes that emerged subsequently did not look much like Bretton Woods, but they were - and are - functioning regimes nonetheless. The Jamaica agreement did not produce a non-system.

The Basel Committee was the basis for regime-building for international banking. The Inter-American Organisation of Securities Commissions and Similar Organisations, formed in 1975, began the process of regime-building in the sphere of securities markets. Transformed into the International Organisation of Securities Commissions in 1984, it became the global regulator for its field. Other specialised international regulatory bodies have emerged since to cover the full range of capital flows: loans, bonds, portfolio investments, direct investments etc.

¹⁰⁶ The post-1974 evolution of regime-building through co-operation in international financial regulation is discussed in, for example, Germain, *Global politics and financial governance*, Porter, *Globalization and finance*, and Underhill, Blom and Mugge, *Global financial integration*.

¹⁰⁷ This is discussed extensively from a Marxist point of view in Panitch and Gindin, *Making of global capitalism*. See in particular chapter 3, *Renewing Imperial Capacity*. Seabrooke, in *US power in international finance*, and Eichengreen, in *Exorbitant privilege*, analyse the same events from Realist and Liberal perspectives, respectively.

agreement to amend the IMF's *Articles of Agreement*.¹⁰⁸ Ford, busy campaigning for the presidency when the Jamaica agreement was signed, also overlooked how Rambouillet unlocked the Jamaica accord when he recorded his part in US history.¹⁰⁹ Yet both were significant: for better and worse, they unleashed the powerful forces of financialisation to accompany globalisation throughout the next 40 years.

Conclusions

The US' inability to prevail in the C20 negotiations was repeated when negotiating amendments to the IMF's *Articles of Agreement*. The most contentious amendments concerned the new rules for gold and exchange rates. The US was obliged to make concessions to France on gold remaining an important reserve asset, while France was obliged to make concessions to the US on exchange rates. This was not tit for tat bargaining. By 1975 Washington had scaled back its ambitions for international monetary reform: it no longer sought a comprehensive reform to bring other states' behaviours into line with US preferences and thereby strengthen its hegemony; Washington was reduced to seeking the right for the US, and any state which cared to follow it, of floating its currency over the long-term without penalty. Britain, Germany and Japan regarded France as being as credible a monetary hegemon as the US. Unable to get its way on exchange rate rules through either hegemony by domination or by consensus, the US abdicated international leadership on exchange rate policy in favour of *laissez-faire*. Washington ceased to concern itself with other states' exchange rates; it simply wanted the international community to agree to it floating its dollar. The evident weaknesses in the US position, and the emergence of what some scholars called a "non-system" in place of what they recognised as an international monetary order, fed some scholars' claims the episode validated hegemonic stability theory.

Legalising floating exchange rates, an act of US agency that changed international structures by safeguarding the post-1973 monetary *status quo*,

¹⁰⁸ Simon and Caher, *A time for reflection*

¹⁰⁹ Ford, *A time to heal*

eventually boosted US hegemony and strengthened US structural power. The international monetary order was transformed from a gold-exchange standard to a pure dollar standard. We are now well-aware that sacrificing exchange rate stability in the interests of accommodating global capital mobility played to the US' strengths in financial services, creating a more prosperous US. And floating imposed simultaneous and instant balance of payments adjustment pressures on surplus and deficit states, an outcome Volcker had earlier identified as being good for US competitiveness. Combined, these outcomes helped the US sustain its overseas expenditures on its military activities, development aid and foreign direct investment, all important conduits for projecting US power abroad. It is important to recognise, however, these gains largely came *after* floating had been legalised. Scholars who claim the US used its structural power to create the new international monetary order were premature. The most Washington could do in 1974-76 was to use its negative structural power to block other states from imposing their vision for the new order on the US.

Previous international monetary orders had been managed by a single dominant or hegemonic power that had issued the order's main currency: the gold standard by the British, Bretton Woods by the US, and the CMEA's system by the USSR. The attempt to construct a new international monetary order and manage it by committee, the C20, was unprecedented. The effort was made because the alternative to co-operation appeared to be international monetary chaos born of competing currency blocs. The attempt failed, but the "Free World" did not get chaos, it got markets when it amended the IMF's *Articles*. *Faut de mieux*, markets were permitted to set the most important price in any open capitalist economy: the exchange rate. Markets were also given new freedoms to allocate capital internationally and to trade gold with central banks.

This suited the Foreign Economic Policy Executive, whose ideology under Ford was more pro-market than under Nixon. As neoclassical realist scholars would expect, the Executive regarded its primary monetary task during 1974-76 as resisting the French-led threats to US economic power (through re-introducing a fixed exchange rate order and imposing an uncompetitive dollar exchange rate), while simultaneously retaining a floating dollar to accommodate domestic political pressures from Congress and business. The Foreign

Economic Policy Executive was successful on both counts, and could afford to abandon the US proposal to end gold's role as a reserve asset - a thinly disguised attempt to weaken Europe's economic power - as a matter of secondary importance. Accepting an extension to gold's life as a reserve asset did not jeopardise the Executive's main objective: to float the dollar without international penalty or sanction.

Chapter 9

Conclusions

“US dominance of the non-Communist world is over, both politically and economically, for both international and domestic reasons. The relative might of the US, though it will remain large forever, will continue to decrease...The dollar simply can no longer play the key currency role it played in the past... Resistance to the trends leading inexorably in this direction would be folly.”

(C. Fred Bergsten, 1975)¹

“... one thing is certain, whatever privilege is retained by the dollar will not be sufficient to enable the United States to behave as it has in the past. Gone are the days when the United States could run an immense balance of payments deficit to support foreign commitments, to buy up foreign assets and at the same time pursue a full employment policy at home. It will no longer be able to expend resources at a relatively low cost to the American standard of living.”

(Robert Gilpin, 1975)²

The events described in chapters 4-8 above happened over forty years ago. Yet one can draw lessons relevant to scholars and policymakers now. Three points stand out.

1. *The US used its structural power to block challenges to its hegemony, but could not use it to advance its hegemony*

Strange's concept of structural power is analytically valuable; her use of it to analyse the 1969-76 international monetary events is questionable. She

¹ Bergsten, Dilemmas of the dollar, 509

² See Gilpin, “Three models of the future”, 57.

and other theorists claim the US used structural power to shift the basis of the international monetary order from fixed to floating exchange rates.³ Closing the gold window was certainly an exercise in structural power, but the material in US and British archives do not support Strange's broader contention. In particular, the archives show Ford and Simon had no hegemonic ambition to impose floating exchange rates on an unwilling world: they were content with a *laissez faire* outcome.

Deploying structural power was part of a Washington policymaker's job description well before Strange coined the term for it. Many policymakers sought to modify other states' unwelcome behaviours by changing the international structures that incentivised other states to behave as they did. Policymakers regarded themselves as agents responsible for promoting US interests by creating, maintaining or reforming international structures. Burns and Volcker saw the Bretton Woods regime as a structure advancing US interests because it privileged the dollar and freed the US from the balance of payments constraints affecting other states. They defend the regime: Burns doggedly opposed Nixon's decision to suspend gold convertibility at Camp David in August 1971; Volcker devised his "Plan X" to modernise Bretton Woods while retaining much of its 1944 design. Nixon and Kissinger famously thought in "big picture" terms as they set about protecting US interests by reshaping the structures underpinning the bipolar world and its balance of power. But their tendency to prioritise US foreign and security policy over foreign economic policy resulted in an inconsistent international monetary policy and uneven US support for international economic structures. Shultz's approach to governance included using structural power to achieve international monetary reform.⁴ Ford's Foreign Economic Policy Executive was more inclined than Nixon's to see markets as serving US interests; they wanted markets to be effective and play a larger international role. Consequently Simon

³ See for example Panitch and Gindin, *Making of global capitalism*, Guzzini, *Realism*, Kunz, *Butter and guns*, Mastanduno, "System maker and privilege taker", Seabrooke, *US power in international finance*, and Walter, *World power and world money*.

⁴ Stein describes Shultz as if he were the personification of Strange's structural power: "(Shultz) knew that the object (of governance) was to translate ideas into action. And he knew this process would not be easy. If the conditions for doing it had been favourable, it would probably already have been done. Therefore he was concerned with changing conditions where he could, and where he could not, adapting the ideas so as to get as much as the unchangeable conditions would permit. That gave his actions a malleability that his ideas might not have had" (Stein, *Presidential economics*, 146).

and Greenspan fostered the development of innovative BIS-based technocratic structures intended to underpin growing, market-driven capital flows managed by private sector international banks (many headquartered in the US).

Strange defined structural power as a unitary concept, but I find it more useful when disaggregated it into distinct components: “positive” and “negative” structural power. “Negative” structural power refers to the power to block international structures from operating, or to block other states from imposing their own agenda on the international community. “Positive” structural power refers to the power to introduce structural change, as in the power to impose one’s own agenda or to create new or reformed structures.⁵ Adopting my disaggregated approach to analysing the US’ use of its structural power during 1969-76 might have led Strange and others scholars to a different interpretation of the 1969-76 monetary events.

I found no archived evidence of the US successfully using its positive structural power to drive initiatives creating new international monetary structures favourable to US interests during 1969-76. The structural changes that arose from US initiatives - moving the international monetary order from a gold-exchange standard to a dollar standard, and generalised floating exchange rates - came about more or less by accident: the unintended, but enduring, consequences of supposedly temporary measures directed towards other goals. The US was unable to impose on or persuade the rest of the world to adopt the structural changes it wanted and was obliged to abandon many of its structural change objectives.⁶ Conversely, one finds ample evidence of the US successfully deploying negative structural power: preventing existing structures from operating; successfully blocking other states from imposing their own agenda on the international community; and preventing them from imposing their blueprints for new international structures.⁷ I concur with Dennis Healey’s

⁵ Discussed in chapter 1

⁶ These included: the attempt to persuade the G10 to create a new multilateral organisation in which trade and security issues would be discussed (see chapter 4); new mechanisms to promote accelerated balance of payments adjustment; new obligations on surplus states to undertake adjustment measures; a new monetary order based on fixed exchange rates defined in terms of SDRs; and, abolition of gold’s role as a monetary asset.

⁷ Negative structural power was deployed when Nixon closed the Bretton Woods regime’s gold window by ending the US commitment, enshrined in the IMF’s *Articles of Agreement*, to exchange its gold reserves for dollars presented to it by foreign central banks. The US prevented France from ensuring the C20 prioritised asset settlement issues over adjustment issues in the C20. Shultz and Volcker successfully blocked the move towards

assessment: the US possessed the negative structural power it needed to prevent unwelcome structural changes proposed by other states.

This ability to block others hardly matches up to Strange's claims for a mighty Washington reshaping the international monetary order to its own design. The repetitive pattern of Washington failing to exercise anything beyond negative structural power suggests failure went beyond the workings of the familiar transformation problem whereby a state is unable to convert power to desired outcomes. Failure was more deeply-rooted.⁸ The US was experiencing difficulties in managing its alliances by 1971. Post-war economic recoveries in Europe and Japan were redistributing relative economic power to the US' disadvantage. Many Western governments were uneasy about Washington's handling of the Vietnam War, which undermined US foreign policy legitimacy. Mass public protests emboldened states critical of the US, encouraging leash-slipping.⁹ Legitimacy (and illegitimacy!), it appeared, was fungible; more so than power, where the US continued to experience difficulties in capitalising on its military power in non-security domains, including in international monetary affairs. Even the FRG was at times willing to put its support for France and European integration ahead of its traditional, security-driven support for the US foreign policy.

The relative decline in US power and the White House's response during 1971-74 led some scholars to conclude the period 1968-74 marked a turning point in the trajectory of US hegemony toward terminal decline.¹⁰ This, as we now know, was too strong a conclusion. However, those who attributed the instability in international monetary relations to a deconcentration of power in the US and its hegemonic decline appear to be on firm ground after 1971.¹¹

compromise and a conclusion of the C20 process in September 1973. Simon prevented France from securing an enhanced role for gold in the post-1976 international monetary order.

⁸ There were, of course, instances of the transformation problem at work, as in 1972 when the US let it be known it would veto any attempt to reappoint the popular Pierre-Paul Schweitzer as the IMF's Managing Director. The US further irritated the IMF Executive Board's membership through its ham-fisted attempt to disrupt and delay the IMF staff's work on international monetary reform. A disgruntled IMF membership subsequently elected Sir Jeremy Morse to serve as chairman of the C20 Deputies committee rather than the US' preferred choice.

⁹ States became increasingly willing to oppose the US on issues unrelated to Vietnam.

¹⁰ See, for example, Wallerstein (*Decline of American power*, and "The Curve of American power"), Arrighi ("Hegemony unravelling", parts 1 and 2, and *Long twentieth century*) and their Realist counterpart Modelski (*Exploring long cycles* and *Long Cycles*).

¹¹ See, for example, Bergsten, *Dilemmas of the dollar*, Bergsten, Keohane and Nye, *International economics*, Cohen, *Organizing the world's money*, Gilbert, *Quest for world*

Hegemonic stability theory appears to offer a more fruitful framework for analysing the 1969-76 period in international monetary relations than the now-popular theory that events were driven largely by the US exercising its structural power. Yet, by failing to recognise the distinction between positive and negative structural power, hegemonic stability theory exaggerates the impact of the deconcentration of power in the US. After all, the Bretton Woods regime was terminated by decisions Nixon took to address US vulnerabilities, not by events forcing themselves on the US. And the US had enough structural power to block French and European attempts to create new international structures the US did not welcome. The US' underlying problem was that it lacked the positive structural power to create the structures it believed were necessary to support its preferred international monetary order.

Lessons can be drawn from this:

- Excessive reliance on theory may cloud one's perspective of events until archived materials become accessible. Archival research is essential to understanding, but so is theory and scholars must continue to theorise! After all, Gowan "global gamble" theory was almost right, except Nixon did not gamble on the US making relative gains from an oil crisis, as Gowan claimed, but on the US coming out ahead by provoking a crisis in European integration, as demonstrated by US archived materials.¹² And although Strange misread the international monetary events of 1969-76,

monetary order, Ikenberry, *Liberal leviathan*, Meier, *Problems of a world monetary order*, and Nye, "Independence and interdependence".

¹² Gowan, in *Global gamble*, theorised Nixon had gambled with the economic health of the US' allies in order to strengthen US hegemony over the Western alliance. He was right, but not in the way he believed. Gowan argued the US gambled by prompting OPEC to raise world oil prices, a move that was more damaging for oil importing Europe and Japan than it was for the oil self-sufficient US. Evidence in the US archives contradicts Gowan's hypothesis: it reveals Kissinger, Shultz, Burns and Volcker were vexed by OPEC's price increases and the associated oil embargo, telling their G5 peers they regarded this as tantamount to economic warfare. But the archives also reveal Kissinger, with Shultz's and Volcker's acquiescence, was willing to gamble with the future of the international monetary order. Kissinger stepped in at the very moment a spirit of compromise was emerging in the C20, a moment when Shultz was actively preparing the US financial and business communities for the compromises he would have to make to secure agreement to international monetary reform in the C20 (a neat reversal of the direction of causation usually analysed in neoclassical realist theory!). Kissinger demanded Shultz and Volcker delay prospective C20 agreement until he had obtained what he and Nixon wanted from the obstructive Europeans in the Year of Europe negotiations. US and British archived documents confirm Shultz and Volcker complied; C20 agreement was postponed, with the US gambling an agreement could be reached once Kissinger had achieved what he wanted in the Year of Europe. So Gowan's apparently preposterous theory about US tactics was almost right!

her concept of structural power, especially when disaggregated into its “positive” and “negative” components, is valuable.¹³

- For policymakers, the lesson is that if other states are to prevail over US wishes, US structural power, be it in its positive or negative guises, must be counterbalanced collectively. The magnitude of US power relative to that of almost any other state implies an individual state is unlikely to be successful when opposing the US alone; collective action may be more fruitful. This is obvious, yet has been ignored in the period since 1976 by numerous states from Grenada to Iraq; North Korea and Iran continue individually to test the limits of US power. The counterpart lesson for US policymakers is that a “divide and rule” tactic may pay dividends in the short-term by discouraging other states from balancing against it, but the tactic’s repeated use may prove counterproductive. The divided states will learn from experience and may unite to balance against the US: Both the US and smaller states learned from Kissinger’s failure to divide the EEC in the Year of Europe negotiations.

2. *The US attempted to use the 1969-76 international monetary crises to strengthen its hegemony under Nixon; Ford did not*

British and US archives catalogue US attempts to use international monetary crises to strengthen its hegemony. Under Nixon, Washington invariably sought to strengthen the US’ power relative to that of its allies, including efforts to strengthen US security. They adopting some policies scholars have overlooked. Archives reveal Kissinger, supposedly disinterested in economic affairs, was always at the heart of policymaking when attempts were made to subordinate US foreign economic policy to foreign policy: he wanted to leverage US economic power into strengthening US security. This

¹³ Strange was not the only advocate of structural power explanations to misread events. Seabrooke, for example, claimed the US successfully repelled other states’ attempts in the C20 negotiations to replace the dollar with the SDR as the international monetary order’s main reserve asset (Seabrooke, US power in international finance, 85). In making this claim Seabrooke ignores the fact that replacing the dollar with the SDR as the order’s main reserve asset (and the order’s numéraire) was a key component of the US plan for the international monetary reform Shultz and Volcker worked to achieve.

ended when Ford replaced Nixon: the US lost the political will to act as an international monetary hegemon.

Hegemons must be capable of projecting their power abroad when creating and maintaining international order. US hegemonic power projection routinely took several forms: sustaining military bases and operations abroad; engaging with and influencing developing countries through development assistance programmes; and, undertaking economically-influential direct investments abroad through US-based multinational companies. These activities had to be financed. The US funded them from its trade surpluses for most of the period after 1945. But US relative economic power was in obvious decline by 1971: the US trade and current accounts were in deficit in 1971, the first deficit in more than a century for the trade account. Military and hegemonic commitments were larger than the US economic base could sustain. The problem risked becoming critical at any moment because the Bretton Woods regime left the US vulnerable to crises: the US' dollar-denominated debts to foreign official creditors dwarfed its gold reserves, risking a run on US gold reserves.¹⁴ Moreover, neither the US nor any other state could counter the vast sums the Eurodollar market was able to mobilise against Bretton Woods' fixed exchange rates.¹⁵ Consequently the regime was fragile, dependent on the Eurodollar market's views of exchange rates. Foreign exchange market crises in May and August 1971 were the Bretton Woods regime's final distress calls, signalling the Eurodollar market was withdrawing its support.

Nixon and Kissinger recognised US hegemony was eroding. They fretted about an impending decline in US leadership and expected the bipolar world of 1971 to give way to a new multipolar world in which economic power would be the key to other types of power.¹⁶ They forecast "five great Superpowers" (the US, USSR, China, EEC and Japan) would in future determine the world's fate.¹⁷ But they were not going to surrender the US' status as the "Free World's" leader without a struggle. Nixon's international monetary initiatives were aimed at shoring up and prolonging US hegemony:

¹⁴ By 1971 only \$11bn of US gold reserves backed the \$38.5bn of officially-held US external liabilities.

¹⁵ Table 4.1, chapter 4

¹⁶ Discussed in chapters 3-7 above.

¹⁷ See chapter 3's discussion of Nixon's and Kissinger's views.

- closing the gold window to end the US' vulnerability to a run on US gold reserves;
- devaluing the dollar in December 1971 and again in February 1973 to boost competitiveness and enable the US to earn the trade surpluses needed to fund its power projection policies;
- reforming the international monetary order in the C20 to shift some adjustment costs from deficit states (including the US) onto balance of payments surplus states, notably the FRG and Japan, as well as create new policy freedoms for the US, including the freedom to depreciate the dollar;
- disrupting European integration in 1973 to increase the US' relative power; and,
- leveraging US economic power from the C20 negotiation into the Year of Europe's security dialogue to buttress the US' negotiating position.

Nixon regarded international structures from a hegemon's perspective: a hegemon should use its agency and leadership role to create and sustain international order, and put in place the structures necessary to support its order. In Nixon's eyes structures were the hegemon's handmaiden. They existed to promote US interests and, if they did not, were subject to reform or abolition. Ikenberry was right about hegemons profiting from their investments in regimes; Nixon showed hegemons also knew how to cut their losses.¹⁸

Archived materials reveal Nixon did not allow international structures to impede his efforts to strengthen US power and hegemony. Initially he worked within the Bretton Woods regime's structure, ordering Kennedy and Volcker to tackle the regime's liquidity and adjustment design flaws. He was happy to pocket their progress on liquidity issues, less content with their lack of progress on adjustment. Connally encouraged him to think of the IMF as an out-dated constraint, a "museum". Nixon had no qualms when he smashed the Bretton Woods regime to end the US' vulnerability to a run on its gold reserves. Better that, in his and Connally's view, than putting US leadership at risk.¹⁹ Nixon had a similarly low regard for the EEC. He and Kissinger concluded in March 1973 the US' strategy towards Europe had been misconceived and further European

¹⁸ Ikenberry, *Liberal leviathan*, 108

¹⁹ See chapter 4

integration was not in the US' interests.²⁰ With Kissinger's active support, Nixon attempted to disrupt European integration in 1973 and degrade the EEC structure. He targeted destruction of Europe's new monetary union, aiming to set Europeans at each other's throats in his attempt to strengthen the US' hand in the Year of Europe security negotiations.

Ironically, Nixon's and Kissinger's choice of weapon was made with the US' international reputation and legitimacy in mind. The US could have intervened selectively in foreign exchange markets to wreck the EEC's fixed exchange rate Snake, but US responsibility would have been obvious and might have attracted European retaliation. Kissinger was adamant the US should appear to have clean hands. The Treasury advised him the EEC's fixed exchange rate currency Snake would self-destruct were it to float against the dollar, so Kissinger lured the FRG into persuading EEC states to float their Snake currencies "temporarily" against the dollar. This diplomatic trap, not US structural power or hegemonic decline, triggered generalised floating exchange rates: OPEC ensured floating was anything but temporary.

Reassembling a fixed exchange rate-based international monetary order was a key US foreign economic policy objective. Shultz and Volcker were close to success in September 1973, only to be knocked off course by Kissinger intervening again in US foreign economic policy for security policy purposes. (Kissinger persuaded Shultz to block the C20's progress until the US had achieved success in the Year of Europe negotiation, an unsuccessful attempt at leverage.)²¹ Kissinger intended to delay Shultz's C20 success; OPEC terminated it. It restructured the world economy by quadrupling oil prices, and

²⁰ Discussed in chapter 6

²¹ US archive material shows Kissinger intervened decisively in international monetary affairs through his involvement in the C20 process in August 1973. With Nixon distracted by Watergate, Kissinger derailed progress in the C20 at a critical moment in the hopes of strengthening the US' hand in the Year of Europe negotiations. This is not widely appreciated. Although Burns' *Secret diary* allude to Kissinger's damaging meddling in international monetary affairs, Nixon's, Shultz's, Stein's, and Volcker's respective memoirs do not mention it, nor have scholars such as Odell (in "Emergence of flexible exchange rates" and *US international monetary policy*) and Silber, in *Volcker*, elicited this information in conversations with policymakers in the Foreign Economic Policy Executive. Scholars' analysis simply does not feature Kissinger's influential role in international monetary affairs after autumn 1971, when Kissinger threw his weight behind Burns on international monetary policy. The archives alone reveal the extent and the hegemony-strengthening purpose of Kissinger's involvement. He, with Nixon, not only subordinated US foreign economic policy in the C20 to their wider foreign policy priorities, but was prepared to take risks - to "gamble" to use Gowan's *Global gamble* language - with the economic health of the Western alliance in the hope of strengthening US hegemony over that alliance.

creating a new demand for free capital mobility, effectively abolishing the need for fixed exchange rates.

Nixon's low regard for international economic structures was such that he put his own domestic political interests ahead of those of the fixed exchange rate-based Bretton Woods regime. He instructed Burns to run an expansionary monetary policy and create an economic boom in time for the 1972 presidential election. Burns' observance of the Federal Reserve's statutory independence was sporadic. He complied with Nixon's demands and increased the broad money supply by more than one quarter in his first two years as chairman of the Federal Reserve. No fixed exchange rate order could withstand this rate of increase in its main reserve asset. The foreign exchange market gaskets blew in May and August 1971 and January/February 1973, with Britain, Italy, Switzerland and Japan sequentially joining Canada in floating their currencies unilaterally ahead of the G10 adopting generalised floating in March 1973.

Nixon consistently sought to strengthen the US' hegemonic position and provide international leadership. He adopted inconsistent tactics in international monetary affairs, however, veering from hegemony by consent to hegemony through domination and back again.²² His initial effort at international monetary reform (1969-70) was an exercise in hegemony by consent. He turned to hegemony through domination when closing the gold window and unilaterally imposing a 10% import surcharge in the Connally-led effort to brow-beat allies into opening their markets to US exports, appreciating their currencies against the dollar and taking on a larger share of the West's defence burden. Kissinger persuaded Nixon to end this tactic when he saw Connally split the Western alliance ahead of Nixon's visits to Beijing and Moscow; Nixon returned to using hegemony by consent tactics in the December 1971 Azores Summit with Pompidou and the G10 Smithsonian Agreement. Shultz relied on the hegemony by consent tactic in the C20 negotiations (September 1972 – June 1974). Hegemony by consent in the C20 was, however, punctuated by episodes of hegemony through domination: in February 1973 (when Volcker engineered a rapid G10 currency realignment, treating Japan especially harshly); March 1973 (Kissinger luring the EEC into generalised floating; and August-September 1973 (when, at Kissinger's instigation, Shultz and Volcker

²² The different categories of hegemony are discussed in chapter 2.

blocked progress in the C20 in the hope of leveraging gains for Kissinger in the Year of Europe negotiations).

Erratic hegemonic tactics, combined with growing awareness abroad of Watergate's impact on Nixon's political authority, undermined US legitimacy, compromising Washington's ability to provide international leadership.²³ The West's chaotic and unco-ordinated response to OPEC's oil price increases highlighted the absence of effective US leadership.²⁴ US hegemony hung in the balance: follower states questioned whether they should still regard the US as their hegemon; some even refused to invite Nixon to visit their territory.

US military and economic power was unchanged when Ford abruptly replaced Nixon; but the domestic political divisions Watergate created sapped the US' will to provide international leadership and ensured US legitimacy was at low ebb, reducing follower states' demand for US hegemony. Britain, the FRG and Japan admitted in 1975 they were as willing to regard France as their international monetary hegemon as the US.²⁵ Urged by Kissinger to reclaim US leadership, Ford endeavoured, with some success, to rebuild the international appetite for US hegemony during 1974-76, including US monetary hegemony. He sought consensus through consultation (at Rambouillet) and compromise (on new rules for gold) and avoided attempts at domination when revising the IMF's *Articles of Agreement*.

Rebuilding confidence in US leadership was achieved at a price, however, including a period in which the US opted out of the order-building tasks one would normally expect a hegemon to perform. Whereas Nixon had

²³ Watergate's impacts are discussed in chapter 3

²⁴ OPEC played a more important role in undermining the US' approach to international monetary reform and reshaping what would be required of reform in the future than was understood at the time. The archives show senior policymakers and officials often dismissed OPEC's influence, describing OPEC's intervention as the pretext, not reason, for dropping US and European attempts at achieving international monetary reform based on new rules for adjustment and asset settlement, respectively. In retrospect, however, it is clear OPEC used its own "positive structural power" to redistribute international political and economic power and, probably without intending to do so, altered what the global economy needed from a reformed international monetary order. The enlarged capital flows funded by OPEC's massive trade surpluses, eagerly sought by oil importers, forced open the cracks the Eurodollar market had inflicted on the Bretton Woods international monetary order. Fixed exchange rates had proved almost indefensible in the face of Eurodollar market speculators' pressures during 1971-73; capital flows stemming from OPEC trade surpluses raised these pressures to tsunami-like levels by magnifying the volume of international capital and the urgency of the capital-importing states' needs. This gave currency and financial markets a much greater say in exchange rate determination and in the level of current account and government budget deficits a state might credibly seek to finance.

²⁵ Chapter 8

seen US international leadership as an electoral asset, Ford saw it as a distraction from his main task of uniting a nation divided by Watergate and split by his pardoning Nixon.²⁶ Ford concentrated on domestic tasks, not foreign affairs. Domestic issues were paramount; the US had no political will to act as hegemon. The 1975 Rambouillet Economic Summit compromise on exchange rates was achieved in part because Ford accepted *laissez faire* on exchange rate rules (as he had earlier when compromising with France on rules for gold), leaving the international monetary order to evolve rather than, as Kissinger had wanted, seeking to impose US preferences on it. Under Ford, the US ceased to attempt to leverage the international monetary crisis into its hegemony.

US engagement with the international monetary crisis of 1969-76 revealed lessons on international leadership and structures relevant today:

- Provided the US has the capacity to lead, it will insist on leading the international community on issues that affect its vital interests.²⁷ Follower states must expect the US to vary its leadership tactics on issues, from hegemony through domination to hegemony by consent. Washington will use whichever works.
- Hegemony involves the US in accepting risks (of a run on its gold reserves under the Bretton Woods regime) and costs not faced by its follower states (such as the inability to depreciate the dollar under the Bretton Woods regime). Tensions between the US and its hegemonic followers are inevitable because there is no pre-agreed price in terms of the privileges that follower states should concede to the US as “payment” for its leadership. Moreover the price of leadership is variable, not fixed; the US and its hegemonic followers can be expected to disagree when one or the other seeks to change this price over time. These tensions are not necessarily a sign of fundamental problems in relations between a hegemon and its followers.
- The US may not always possess the capacity to lead.²⁸ Ford took office when the US was seriously weakened by its internal divisions and in no

²⁶ Opinion polls show public opinion was overwhelming against Nixon on Watergate and split 50:50 on Ford offering him a pardon.

²⁷ “The US is a great leader but a lousy team player” is part of the Foreign and Commonwealth Office’s oral tradition.

²⁸ Recall from chapter 2, my definition of hegemony included a state’s political will to act on the international stage.

position to offer international leadership or credibly claim the legitimacy that makes leadership acceptable to follower states. He abdicated leadership on international monetary issues. With the US population currently deeply divided, this time in its attitudes towards the Trump administration, the precedent from the 1970s may have implications for foreign policy design in the US and in follower states.

- Just as a hegemon will create international structures to support an international order it has put in place, it will seek to replace structures that no longer suit its purpose, either by reforming or destroying them. The 1969-76 international monetary experience demonstrates destruction may be easier than reform. Destruction is likely to require a hegemon to use merely its negative structural power, as when the US destroyed the Bretton Woods regime, whereas reform is trickier, requiring positive structural power. As the C20 negotiation demonstrated, much will depend on the demand for the structure and its disciplines among the hegemon's follower states. A hegemon may of course lack the negative structural power to destroy structures it dislikes, as when the US failed to damage the EEC critically in 1973, which perhaps provides grounds for believing the Paris Agreement may survive the US announcing its withdrawal in 2017 to become a climate change free rider.

3. US structural power was limited by the need for international legitimacy

What were the limits on US positive structural power during 1969-76 that prevented the US from exercising it successfully? The answer cannot be found in material resources. As now, the US' military power dwarfed that of the states with which it was negotiating. Moreover, US economic power increased in absolute terms during 1969-76, even though it continued to decline relative to some other states, notably the FRG, Japan and the OPEC cartel.²⁹ It is more likely the limits on US positive structural power were imposed by the US' need

²⁹ There was a perverse moment in summer 1973 when France became more amenable to compromises on US terms in the C20 negotiations because it feared US relative economic decline might lead to US military cuts in western Europe.

to secure international consent to its reforms, and thus win legitimacy for the new order it was attempting to create.

The US was the Western alliance's predominant power during 1969-76. This did not give it the power to impose its will on the G10 through Soviet-style coercion: Nixon's unilateral closure of the gold window and imposition of a 10% import surcharge came close to this by attempting hegemony through dominance, but proved costly to the US in terms of a loss of consent and diminished alliance cohesion. Washington could not sustain the tactic and achieve its security objectives in Moscow and Peking in the absence of allies' consent. Consent was important because tightening economic constraints required the US to wield power efficiently and effectively, including in the monetary arena. Without consent, any US-proposed new international monetary order would have lacked legitimacy: compliance would have been grudging, limited and patchy; the US' order-maintenance costs would have been high; and the capitalist world might have fragmented into the competing currency blocks as the US Treasury feared. By contrast, obtaining other states' consent to reform of the international monetary order changes would have conferred legitimacy, resulting in other states voluntarily living with the rules they had endorsed, thereby minimising US order-maintenance costs.

The US' need for other states' consent went beyond mere agreements on the details of the new monetary order's structure, or on the systemic behaviours that would be mutually acceptable within that new order. It required international agreement on three fundamental issues: the US' hegemonic right to establish an international order; agreement on how it would maintain that order; and agreement on the material and political advantages that would be ceded to the US in recognition of the risks and costs it would bear as hegemon when creating and maintaining the new order. All three issues were contested during Nixon's period in office. European opposition to US plans for international monetary reform in the C20 was an open challenge to the US' hegemonic right to design and benefit from a new monetary order. Europe also challenged what some scholars called the "Grand Bargain" of the post-War world in which the US provided Europe and Japan with security in exchange for

the dollar's privileges.³⁰ US exploitation of these privileges was especially contentious in Europe: France called them "exorbitant". The EEC's currency Snake could be seen as a European attempt to diminish the dollar's privileges by creating Europe's own currency block: archived materials indicate this is how the US Treasury viewed it at the time. Clearly, there was no international consensus on the US' approach to delivering monetary hegemony in the early 1970s or the price Washington could charge for it.

The US' need for legitimacy extended to its use of negative structural power. This created problems for Washington. Legitimacy, consent and consensus matter in international monetary affairs, especially given the US' use of international regimes and institutions to diffuse its hegemony.³¹ Using negative structural power to undermine other states' consent or to disrupt or destroy an international consensus or legitimate agreement may be successful initially, but risks being counter-productive over the longer-term. Nixon's Foreign Economic Policy Executive was slow to accept this and consequently experienced repeated failures in its international monetary policies.³² Ford's Foreign Economic Policy Executive arguably made better use of US negative

³⁰ See, for example, Mastanduno's "System maker and privilege taker". One of Kissinger's stated purposes for embarking on the Year of Europe initiative was to counteract the transatlantic alliance's fraying consensus.

³¹ Clark, *Hegemony*

³² Three examples serve to make the point that using negative structural power may be counter-productive:

- Nixon closed the gold window and imposed a 10% import surcharge in August 1971. He hoped other G10 states would concede an exchange rate realignment that would boost US competitiveness, liberalise their trade restrictions to reduce barriers to US exports and change defence burden-sharing arrangements in the US' favour. But other states regarded the US' actions as illegitimate because they violated international norms and rules and they would not consent to making the concessions the US wanted, or at least not to the extent Nixon hoped. Nixon had to back down (chapter 4).
- At the December 1971 Azores Summit, Kissinger and Connally convinced Pompidou the US would defend the parities established in the Smithsonian Agreement. When the US failed to do so in 1972, the agreement's legitimacy was compromised. Other states felt as free as the US to ignore the Smithsonian Agreement's exchange rates. The UK felt it was not violating a binding international commitment when it unilaterally abandoned its Smithsonian parities and floated sterling in July 1972. Sterling depreciated against the dollar, leaving the US in a less competitive position than it would have been had it worked to maintain all states' observance of the Smithsonian Agreement's terms (chapters 5 and 6).
- With an international consensus building in summer 1973 in favour of reaching an outline C20 agreement on terms broadly favourable to the US, Kissinger intervened and demanded Shultz delay agreement in the C20 until the US had made greater progress on securing its Year of Europe negotiating objectives. Shultz complied, only to find agreement on his preferred terms had not been merely postponed, it had been made impossible during the delay. The US never obtained the international monetary reform he and Volcker had worked for (chapter 7).

structural power by being more selective in its deployment and limited in its application.³³

Ford's *laissez faire*, permissive approach to international monetary reform was a realistic response to the constraints on the Foreign Economic Policy Executive in 1974-75. Watergate and its domestic aftermath consumed political attention in the US and weakened US legitimacy abroad. The US had little domestic political will to provide international leadership when so much needed to be put right at home; and there was limited international appetite for US hegemony. OPEC complicated international monetary affairs by initiating a huge redistribution of political and economic power, and restructured the world economy. Raising oil prices earned massive trade surpluses for OPEC members, but these needed recycling to oil importing states or the world economy would grind to a halt. International capital mobility (and new conduits through which capital would flow) were essential for this task; fixed exchange rates were a luxury few could afford.

The choice of Mundell trilemma policy combination was crucial to the durability and legitimacy of any future international monetary order's design, but by 1974 the US had lost the authority and power it needed to establish this central norm.³⁴ The Rambouillet *laissez faire* compromise on exchange rate rules was recognition of the vacuum where US monetary hegemony had been.

The US and Europe were free to pursue distinct monetary policy objectives. The Foreign Economic Policy Executive's international monetary policy choices took account of OPEC's impact on the global economy as well as domestic political imperatives. It was appropriate – economically and in

³³ Ford limited his administration's international monetary objectives to blocking French ambitions for new exchange rate rules and constraining France's gains on new rules for gold. And he limited the US' exchange rate rules objective to negotiating an unambitious, *laissez faire*, compromise with France, using this agreement as a basis for mobilising a consensus among all IMF member states, and subsequently legitimising the Franco-US compromise by embedding it in a new international rule when the IMF's *Articles of Agreement* were amended in 1976.

³⁴ An international order that is not durable is unlikely to command legitimacy, and durability will depend on the international community reaching a settled agreement on the order's central objectives. Mundell examined the conditions under which an international monetary order might be durable. He reasoned that policymakers could choose no more than two of three desirable monetary objectives: national monetary policy independence; free capital mobility; and fixed exchange rates. Any combination of two policy choices would be viable, but selecting three would not: the order's internal contradictions would render it unstable and it would eventually explode. Thus a coherent and durable international monetary order must have at its heart a consensus among its member states on which two of the three policy objectives they would pursue, and which they would jettison. Chapter 1 discusses this in greater detail.

neoclassical realism terms – for Washington to combine US national monetary policy independence with free capital mobility and floating exchange rates.³⁵ If he were to achieve his domestic political objective of curbing inflation ahead of the 1976 presidential election, Ford needed the US to retain control of its national monetary policy. Free capital mobility was economically essential in a global economy buffeted by large, oil-driven current account imbalances, as well as good for US financial services exports. European Snake member states, however, clung to the monetary policy combination that had been at the heart of the Bretton Woods regime - national monetary policy independence combined with fixed exchange rates and capital controls - despite OPEC having rendered the combination redundant. Even if “core Europe” had not refused US monetary leadership, the US under Ford lacked the political will to act as a monetary hegemon. Ford had an election to win. He was happy for other states do what they legitimately wished within the confines of the amended IMF *Articles of Agreement*, provided the US was also free to adopt the international monetary arrangements that best suited its national needs. Thus, having failed to impose its own vision of a reformed international monetary order in the C20 negotiations, the US abdicated the hegemon’s role of creating a new order to fill the gap left by Bretton Woods’ demise.

The US did not lose all interest in international financial co-operation, as demonstrated by its tentative steps at the BIS to build a new international financial order capable of dealing with the banking supervision and other cross-border issues created by internationally-mobile capital.³⁶ This contradicts

³⁵ Canada, Italy and the UK also adopted this policy configuration.

³⁶ The US saw a need to regulate international banks and persuaded the G10 to create, and the BIS to host, the Basel Committee on Banking Regulations and Supervisory Practices (later renamed the Basel Committee on Banking Supervision – the BCBS) in 1975. The Committee’s membership comprised representatives from the central banks of G10 states plus Luxembourg. It was intended to be unlike the IMF: highly informal, with no founding treaty, formal decisions or permanent secretariat. It provided a forum in which members could share information, produce and discuss problem-focused technical papers and agree common standards for bank regulation. The agreed standards were intended to be adopted by national regulatory agencies, and not be imposed multilaterally by the BCBS.

The first steps for building a new financial order were taken in 1975 when the BCBS tackled the issue of who would be responsible for regulating banks. In its “1975 Concordat” the BCBS agreed home country regulators would regulate the head offices of banks and host country regulators would regulate the offices of offshore banks located in their jurisdiction. The Concordat on banking supervision responsibilities was tightened when banks began to game the system by moving to the most lightly-regulated jurisdictions. The BCBS was subsequently drawn into regulating precisely how regulated banks should operate, tackling issues such as capital adequacy and risk definition and pricing. See Porter, *Globalization and finance*, and Underhill, *The new world order*, for discussions of the origins of the new international financial

Sterling-Folker's argument that the US would abandon the pretence of international co-operation once a crisis had passed.³⁷ Frustrated in its efforts to create a new international *monetary* regime, the US began to build the new, broader, international *financial* regime needed to cope with states liberalising their capital accounts. This shift in regime-building from monetary to financial issues was also marked by a shift in the type of regime the US wanted to build, as Slaughter pointed out.³⁸ This may explain why some scholars, including Sterling-Folker, Solomon and Williamson expressed fears of a "non-system" being created because they failed to recognise regime-building innovations.³⁹

The US' approach to hegemony is based on operating through international regimes and international co-operation. This leaves the US vulnerable to challenges to: its hegemonic legitimacy, its selective approach to order-maintenance and its demands for political and material privileges in return for accepting hegemonic risks and costs. Evidence of challenges can be seen in the fierce arguments between "Old Europe" and the US that preceded the second Gulf War; Russia contravening US-supported international norms on the "near abroad" states' territorial integrity; and, China's using its growing economic power to question the legitimacy and durability of US financial regime-building.

US hegemonic legitimacy is never a "done deal" because Washington must constantly strive to win consent for its policies and a consensus on their implementation against a background of anarchy and constant shifts in the

order. Underhill, Blom and Mugge, *Global financial integration thirty years on*, provide updates on subsequent regulatory trends and developments.

³⁷ Sterling-Folker argues multilateralism leaves no lasting impression in Washington because US policymakers see it as a "quick fix" in a crisis, but abandon it shortly after the crisis, preferring unilateralism to multilateralism (Sterling-Folker, *Theories of international co-operation*, 214).

³⁸ Slaughter, "Governing the global economy"

³⁹ Sterling-Folker failed to spot the US' continued interest in international co-operation and its order-building efforts in the Basel Committee on Banking Supervision. She stated "It is difficult to find any evidence for regime creation in US international monetary policy between 1971 and 1976..." and "... not much evidence for regime creation" post-Rambouillet (Sterling-Folker, *Theories of international co-operation*, 151). Solomon, *International monetary system*, and Williamson, *Failure of world monetary reform*, feared the 1976 amendments to the IMF's *Articles of Agreement* had replaced the Bretton Woods international monetary order with a "non-system". Presumably the latter were unaware at the time of Mundell's analysis which demonstrated an international monetary order combining national monetary policy independence with free capital mobility and floating exchange rates could be as viable as one based on national monetary independence combined with fixed exchange rates and no capital mobility, as the Bretton Woods regime had been.

international distribution of power. Co-operation agreements are rarely permanent: states may question, contest or undermine policy areas where the US had previously achieved consensual agreements, not least because changing circumstances may incentivise states to re-open earlier agreements in the hope of extracting a better price for their continued adherence to the consensus. A hegemon's work is never done!

In the absence of domestic political turmoil (which cannot be guaranteed), the US will continue to attempt to exploit international economic, political and military crises to enhance its hegemony, as it attempted to exploit the international monetary crisis of the early 1970s. To do otherwise would raise questions about its hegemonic purposes and legitimacy. Moreover, it explains why the US is always a better leader than a team player. US-built international structures, including international monetary and financial structures, impose a leadership role on Washington whether or not it wants to lead. This is not a "tragedy" in Mearsheimer's sense of the word, but exercising structural power can be a self-imposed trap, as demonstrated in the monetary crisis of 1969-76.

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